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PRESENTATION

Operator

Good afternoon. My name is Hope, and I will be your conference operator today. At this time I would like to welcome everyone to the first quarter 2013 earnings conference call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks there will be a question-and-answer session. (Operator Instructions).

Thank you. Mr. Brian Roberts, General Counsel for Grand Canyon Education, you may begin your conference.

Brian Roberts - Grand Canyon Education, Inc. - General Counsel

Thank you, operator. Good afternoon, and thank you for joining us today on this conference call to discuss Grand Canyon's 2013 first quarter results.

Speaking on today's call is our President and CEO, Brian Mueller, and our CFO, Dan Bachus. This call is scheduled to last one hour.

During the Q&A period we will try to answer all of your questions, and we apologize in advance if there are questions we are unable to address due to time constraints.

I would like to remind you that many of our comments today will contain forward-looking statements with respect to GCU's future performance that involve risks and uncertainties.

Various factors could cause GCU's actual results to be materially different from any future results expressed or implied by such forward-looking statements.

These factors are addressed in GCU's SEC filings, including our annual report on Form 10-K for the fiscal year ended December 31, 2012, our quarterly reports on Form 10-Q, and our current reports on Form 8-K. We recommend all investors thoroughly review the reports before taking a financial position in GCU, and we do not undertake any obligation to update anyone with regard to the forward-looking statements.



With that I will turn the call back over to Brian.

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Good afternoon. Thank you for joining Grand Canyon University's first quarter fiscal 2013 conference call. We are pleased with the results of the quarter.

Our long-term goals are to grow enrollment 8% to 10% per year, revenues 10% to 12% per year, and achieve pre-tax margins of between 23% and 24%.

As we will discuss in greater detail later in the call, our revised 2013 guidance is for enrollment to grow between 9% to 10.5%, revenues 13% to 14%, and pre-tax margins to be 23.5%. We are currently achieving these results in spite of growing much faster than expected in 2012.

In the first quarter of 2013 enrollment grew by 15.7%, revenues by 21.3%, pre-tax margins are at 23.7%, and new enrollment were up in the mid-single digits year-over-year.

We believe that this success is the result of a differentiated model. This hybrid model, which combines a traditional campus and on-line campus leveraging a common infrastructure, produces high quality, low cost education whose brand is rooted in a strong, growing, vibrant traditional campus.

In addition to building the brand of the institution, the traditional campus is providing the strong tailwind from a growth perspective.

The next three years our overall growth rate will be between 8% and 10%. Our traditional ground students the next three years will grow by approximately 30% in 2013, approximately 23% in 2014, and approximately 20% in 2015.

These students, in spite of very low tuition rates, also have a positive impact on revenue and earnings growth because of their four-year revenue streams, very high retention rates, low acquisition costs and low bad debt expense.

This tailwind allows us to grow our on-line student body by only 6% to 8% per year, enabling us to stay focused on quality students in the high graduation rate programs.

Last quarter I listed five reasons why we are getting these results, and I want to update you on those today. The first is the growing strength of the traditional campus and its overall impact of the brand of the institution.

We started fall of 2012 with approximately 6,500 students on our campus in Phoenix. We expect to start fall of 2013 with approximately 8,500 students on the ground campus.

Of those registered and fully admitted so far, their average incoming GPAs are approximately 3.5. This year we raised the minimum GPA requirement for admission to 3.0. We expect the retention of the traditional ground students between spring of 2013, which we just completed, and fall of 2013 that did not graduate to be 88%.

Approximately 50% of our students are studying in the hard sciences. We expect to extend our reach into STEM education by rolling out degrees in engineering and technology early in 2015.

The second reason for the success is the high quality composition of our on-line student body. In our working adult student body 42.2% are studying at the graduate level. These students have high graduation rates, low default rates, and low bad debt expense.

By college, our College of Nursing and Health Sciences students produced the highest retention rates, and they went from 26.7% of our student body last year to 29.7% this year.



This year our College of Education students, who also produce higher retention rates, dropped from 43.5% to 40.9% of the total students, but the raw number of those students went up again.

College of Liberal Arts students remained flat at 15.3% of our working adult student body. The College of Business students decreased from 14.4% to 14.2% of the total.

A great deal of the enrollment success has to do with increasing retention and graduation rates. This continues to be driven by four major factors. One, increasing selectivity because of higher admissions requirements. Two, continuing to focus on attracting high quality students.

Three, an increasing number of our on-line students being taught by full time faculty. In the first quarter of 2012 19.5% of students in on-line courses were taught by full time faculty. This increased to 23% in the first quarter of 2013.

On ground, greater than 53% of our students are taught by full time faculty, and our goal is that 70% would be taught by full time faculty in two years.

Four, the implementation of technology, which allows us to closely track student attendance, participation and the quality of their academic work.

The third reason for the success is our very competitive pricing model. On our traditional campus our published tuition rate is \$16,500 per year. This fall will be the fourth year we have not raised tuition.

After scholarships, our average student pays about \$7,800 per year. Most private universities have published rates between \$25,000 and \$40,000 per year, and state universities in Arizona are about \$11,000 per year in addition to the tax subsidies that supports each in-state student.

Those institutions also offer scholarships, but our after scholarship averages are very competitive with the tax supported state institution and well under most private institutions.

In addition, our room and board rates for those students living on campus are extremely low. Most students on our campus are paying about \$6,500 for room and board for the entire year. Most universities have rates much higher than that. In fact, some are almost double that amount.

The traditional campus strategy is going so well that we are considering opening a campus in an East Valley city and one in Tucson.

These campuses would have the same traditional campus look and feel of our very attractive, modern and vibrant Phoenix campus and would be built for traditional students.

We would expect to grow each campus to be between 5,000 and 7,000 students in a six- to seven-year time frame. This would add additional strength and years to the overall growth tailwind that already exists.

Our on-line students have close to the lowest tuition rates in the industry. This year we are budgeting a 5% increase in new on-line starts and are not budgeting any increased tuition for our on-line programs.

We believe the demand that exists due to our brand strength and price point would allow us to grow faster and raise our tuition price similar to prior years, but as we have discussed previously, we do not believe this is in the long-term best interest of the University, our students or our investors.

We expect to reach our targeted enrollment, revenue and margin goals because of the continued shift toward the higher quality students that have higher retention rates.

The fourth reason for this success is a flat organizational model with very advanced dashboard technology that gives us the ability to manage the progress of our students on a daily basis. We invested \$90 million in technology advancements over the last three and a half years.



Our academic counseling staff can monitor the attendance and participation trends of students, as well as track their academic process. This allows them to work cooperatively with faculty to provide any intervention necessary to keep students moving in a positive direction.

We are also working hard on the advanced analytics component of our LoudCloud learning management system, which will provide another large amount of data on the academic work of our students and faculty.

The fifth reason for this success is the growing experience levels of faculty, management and staff. The employee retention rate continues to improve through quarter one of 2013 for our operations group, our full time faculty and management, thus increasing the average tenure of our staff and faculty who closely interact with our students. This improvement is causing the instruction and service that our students receive to reach high levels.

The performance areas on campus continue to grow and have an impact on the brand. Our Theater Department just concluded the last of its five major productions and won numerous awards locally. Our various music groups will continue to perform throughout the Southwest during the summer months.

Our Division II athletics program is currently in third place nationally and hopes to move to first place based upon the results of the spring sports. The PR surrounding our move to NCAA Division I in all sports was boosted by our hiring of former Phoenix Suns three-time all-star and former Suns Assistant Coach Dan Majerle and bringing on USA Basketball President Jerry Colangelo as a consultant. These men are two of the most powerful sports icons in Arizona history and have a significant reach in the basketball world internationally.

Turning to results of operations for the first quarter of 2013, net revenues were \$142 million in the first quarter of 2013, an increase of \$24.9 million or 21.3% from \$117.1 million in the prior year period. Operating margin for quarter one 2013 was 23.7%, compared to 20.7% for the same period in 2012.

Net income was \$20.9 million for the first quarter of 2013, compared to \$14.5 million in the prior year period. Net income excluding the gain from the note receivable proceeds of \$2.2 million was \$19.6 million in the first quarter of 2013.

After-tax margin was 14.7%, compared to 12.4% for the same period of 2012. It should be noted that the difference between 23.7% operating margin before income taxes and the after-tax margin of 14.7% is primarily money we pay in taxes that goes back to the taxpayer.

Given our relatively low default rates, our relatively low Pell usage, and the high amount of tax we pay, we are in a net-plus to the taxpayer.

Instructional costs and services grew from \$50.8 million in the first quarter of 2012 to \$60 million in the first quarter of 2013. As a percent of revenue IC&S decreased 1.2% to 42.2% from 43.4%.

Bad debt expense as a percent of revenue stayed flat between periods at 350 basis points. The key factor is the result of four things. One, the increasing quality of on-line students. Two, the growth of our traditional ground student body.

Three, the flat organizational structure and innovative dashboard that allows us to manage the progress of each student to a greater extent than we have before. And four, the increased experience level of our staff.

Employee and faculty compensation and related expenses decreased 100 basis points between years, primarily due to the ability to leverage our fixed costs structure of our campus-based facilities and the employee base across an increasing revenue base, which was partially offset by increased employee benefit costs. Occupancy costs decreased 30 basis points, primarily due to our purchase of an on-campus dormitory in the fourth quarter of 2012 that was previously leased.

Admissions advisory and related expenses as a percent of net revenue decreased 90 basis points from 17.1% in quarter one in 2012 to 16.2% in quarter one of 2013. This decrease was primarily due to the ability to leverage our employee costs across an increasing revenue base, which was partially offset by employee benefit cost.



Advertising expense as a percent of net revenue decreased 40 basis points from 11.6% to 11.2% in quarter one of 2013. Marketing and promotional expense as a percent of net revenue increased 20 basis points from 0.8% in quarter one of 2012 to 1% in quarter one of 2013.

General and administrative costs increased from \$7.5 million in the first quarter of 2012 to \$8.1 million in the first quarter of 2013 as the percentage of revenue decreased from 6.4% in quarter one of 2012 to 5.7% in quarter 1 of 2013. Employee compensation decreased 20 basis points from the prior year. Legal and other miscellaneous expenses decreased 40 from the prior year.

Interest and other income increased \$1.7 million over quarter one of 2012 as a result of proceeds received on a note receivable, partially offset by an increase in interest expense between periods.

As a result of the above, net income increased from \$14.5 million in the first quarter of 2012 to \$20.9 million in the first quarter of 2013.

With that I would like to turn it over to Dan Bachus, our CFO, to give a little more color on our 2013 first quarter and talk about changes in income statement, balance sheet and other items.

Dan Bachus - Grand Canyon Education, Inc. - CFO

Thanks, Brian. Effective during the first quarter 2013 we made changes in our presentation of operating expenses and reclassified prior periods to conform to the current presentation. We determined that these changes would provide more meaningful information.

Additionally, this new presentation better classifies our cost consistently with the operational changes we have made related to the rolls and the responsibilities of our admissions personnel. Specifically, we have separated admissions advisory and related expenses from advertising and marketing promotional expenses, as the admissions personnel role has evolved into one in which a substantial amount of time educating students, not only during the admissions process, but through matriculation and during their program of study. The admissions advisory and related expense category includes salaries and benefits for admissions advisory personnel and revenue share expense as well as an allocation of depreciation, amortization, rent and occupancy costs attributable to the admissions advisory personnel.

The marketing and promotional expense category includes salaries, benefits and share based compensation from marketing personnel and other promotional expenses.

This category also includes an allocation of depreciation, amortization, rent and occupancy costs attributable to marketing and promotional activities.

We have reclassified our operating expense for prior periods to conform to the above disaggregation and revisions to the presentation. There were no changes to total operating expenses or operating income as a result of these reclassifications.

Scholarships as a percentage of revenue slightly decreased from 16.9% in Q1 2012 to 16.6% in Q1 2013, due primarily to a decrease in scholarships for on-line students between years. Bad debt expense as a percentage of revenue stayed flat at 3.5% in the first quarter of 2013 and 2012.

Our effective tax rate for the first quarter 2013 was 40.4%, as compared to 39.7% in the first quarter 2012. The slight increase in the rate between years is primarily due to nonrecurring tax items, which had the effective of increasing our effective tax rates in the first quarter of 2013 and decreasing the effective tax rate in the first quarter of 2012. We still anticipate our effective tax rate will be 40.5%.

We repurchased 215,187 shares of our common stock during the first quarter of 2013 at a cost of \$5.1 million and have purchased another 101,900 shares to date in the second quarter of 2013 under 10b5-1 plans that were put in place.

In addition, our Board of Directors authorized the University to repurchase up to an additional \$25 million, which now represents \$75 million total, and also extended the expiration date on the repurchase authorization to September 30, 2014.



Turning to the balance sheet and cash flows, total cash, unrestricted and restricted, and short-term investments at March 31, 2013, was \$201.4 million.

Accounts receivable net of the allowance for doubtful accounts is \$7.7 million at March 31, 2013, which represents 5.2 days sales outstanding compared to \$7.8 million or 6.5 day sales outstanding at the end of the first quarter 2012.

CapEx in the first quarter 2013 was approximately \$14.7 million or 10.4% of net revenue. CapEx is somewhat seasonal, as much of our construction needed to be completed before our fall start for our ground students is done during the spring and summer months.

Thus CapEx's percentage of revenue is generally higher in the second and third quarters and lower in the third and fourth quarters.

We anticipate the 2013 CapEx will be down slightly to approximately \$80 million and will include two more dorms and an expansion of our student union and library to service the increasing student body.

There was one unusual first quarter 2013 event that I would like to point out to investors. The University purchased a note receivable from a financial institute at fair market value in the fourth quarter 2012 for \$27 million, which was collateralized by real estate, one property of which is adjacent to our campus. The note bore interest at 11%, which represented the 6% rate of the loan plus the 5% default rate.

The principal and most the interest due on the note was paid in March 2013, resulting in the full return on investment on the note receivable and an additional gain in interest income and other income of \$2.187 million on the loan.

However, the borrower disputed certain amounts due under the note agreement, including some of the default interest and the late payment penalty.

The disputed amount of \$2.068 million is being held in escrow. As this amount is in dispute and as a result has been treated as a gain contingency, and thus will not be recorded as a receivable or income until resolution is reached.

Excluding the gain recognized and the tax effect of that gain, our net income and earnings per share for the first quarter of 2013 would have been \$19.7 million and \$0.43 per share respectively.

I would like to touch on one regulatory item. As we discussed on the last quarter's call, our draft two year cohort default rate related to students that went into repayment between October 2010 and September 2011 for students whose last day of attendance in the University was between April 1, 2010, and March 31, 2011, as 12.4%, and our draft three-year cohort default rate related to student loans that went into repayment between October 2009 and September 2010 is 19.9%.

As a reminder our transition to BBAY occurred during the summer-fall of 2010, which is during these periods. We believe that our cohort default rate in future years will return to much lower levels, given the change in our student mix that has occurred, and early data from this next cohort suggests that this should be the case.

We want to remind you that currently 88% of students are paying their loans back with interest, which combined with our tax contribution and that of our growing workforce tax contribution, and the high savings of state dollars because in state students are attending a private university, the net effect on taxpayer of GCU's contribution is very positive.

Last I would like to remind investors of some of the comments we made last quarter regarding our 2013 guidance. Our revenue guidance continues to assume no net tuition increase for our ground campus or on-line campus.

We saw revenue per student growth in the first quarter 2013 and anticipate growth in the second quarter as well, due primarily to retention gains we have experienced over the past couple quarters, last year's working adult tuition price increase, and the increase in ground traditional students as a percentage of the total.



These trends have allowed us to increase our revenue guidance for the second quarter of 2013. As a reminder, we anticipate revenue per student will be down slightly year-over-year in the third quarter due to the ground campus growth and only earning one month of revenue in the quarter, and the fact that we are anticipating that the year-over-year retention gains we have seen over the past 18 months will level off in the second half of 2013. Quarter four we should see a small gain in revenue per student.

On the expense side, bad debt is projected to be up approximately 50 basis points year-over-year, as we do not anticipate collecting as much previously written off receivables as we did in 2012, as the amount of write-offs have decreased over the past year.

The biggest effect of this we believe will be seen in the second quarter, as in Q2 2012 our bad debt as a percentage of revenue was 3.1%, whereas we estimate it would have been closer to 4% without these recoveries.

Division I costs include \$2 million of one-time payments that are not included in our estimates, as we are still working with our auditors regarding the accounting for these payments.

We have also provided updated estimates of diluted weighted average shares outstanding by quarter. Although we might repurchase shares during 2013, these estimates do not assume significant repurchases. They assume increased dilution from stock options and restricted stock granted.

The slight increase in our estimated shares outstanding is due to the effects of the treasury stock method caused by an increase in our stock price.

I will now turn the call over to the moderator so that we can answer questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). We will pause for a moment to compile the Q&A roster. Your first question comes from the line of Sara Gubins, Bank of America.

Sara Gubins - BofA Merrill Lynch - Analyst

Hi, thanks. Good afternoon.

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Hi, Sara.

Sara Gubins - BofA Merrill Lynch - Analyst

I wanted to ask about the pre-tax margin goal that you have talked about of 23% to 24%. You will already be well within that this year, and it seems reasonable to think that you might get to the 24% fairly rapidly as well.

You had talked about reinvesting back into lower tuition at that point. I'm wondering if that's how you are still thinking about it, and when we may expect to start to see that?



Brian Mueller - Grand Canyon Education, Inc. - CEO, President

I think that you are right, thatwe have gotten to between 23% and 24% sooner than we thought, sooner than we anticipated. We are freezing tuition, room and board on our ground campus this year.

I think that we will -- as it looks today we will freeze it next year, and I think you should anticipate that the average amount that our ground student pays remains about the same.

If we lower tuition on the on-line side, it will be in selected programs where we can gain an competitive advantage. So it would not be across the board, but it would only be in selected programs where we think we can get a competitive advantage and therefore get better students. And so I would tell you that I would expect the margins to be around 24%, and there will be selective programs where we'll probably take a tuition decrease.

Sara Gubins - BofA Merrill Lynch - Analyst

Great. And then along those lines, Dan, you mentioned that scholarships were down a little bit as a percent of revenue because of lower scholarships for on-line. Can you talk about how you would expect that to trend?

Dan Bachus - Grand Canyon Education, Inc. - CFO

I think it will probably stay about where it is going forward as a percentage of revenue. As you know, we don't do a lot of scholarships on-line, but included in our scholarship number is the military discount that we give to our military students and then some promotions that might be run during nontraditional start times. And so I just -- I don't see that significantly changing in the future, sol think I would kind model it about flat from where it is this quarter.

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Especially, Sara, because the military discount -- military students are still less than 5% of our total students. Not a significant part of our student body.

Sara Gubins - BofA Merrill Lynch - Analyst

Great. And the last question, you mentioned mid-single digits new enrollment growth. Does that include both on ground and on-line? And I'm wondering if it compares to the high single digit number that you talked about last quarter?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

It is on-line.

Sara Gubins - BofA Merrill Lynch - Analyst

It is only on-line? Okay.

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Yes. And the mid-single digits is definitely a planned amount of new starts, given where we know the new starts are coming so that we can get the total enrollment to between 8% and 10% including ground.



So there is a focus on ground and growing that from the 6,500 or so through 15,000, and then as we open up the other campuses, up to 20,000 and 25,000. And then we fill in with the on-line students to the amount necessary to get a total overall 8% to 10% growth.

And to this point we have been doing that now for about 12 months, and weare -- we've been able to manage the on-line student body to increasingly high qualities. Mid-single digits is enough to get us that 8% to 10% that we are looking for.

Sara Gubins - BofA Merrill Lynch - Analyst

Thank you.

Operator

Your next question comes from the line of Bob Craig of Stifel.

Robert Craig - Stifel Nicolaus - Analyst

Good evening, guys.

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Hi, Bob.

Robert Craig - Stifel Nicolaus - Analyst

Brian, first question, as far as the timing on any new campus openings, you mentioned the East Valley and Tucson, and also any progress in site selection there?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

We are making progress. The cities in the East Valley, Gilbert and Mesa particularly, have some very attractive sites. However, they are owned by -- they don't own the sites.

And so we have to work with both cities to figure out which is the best site, and how they are going to help us with getting those sites. And so that is going along well. We are getting closer.

We had another call with Tucson today. Tucson is very excited. They have got a couple of sites that they actually own. So it would be different down there.

I would say right now it is probably realistically more fall of 2015 versus fall of 2014 that will start students, and probably start both campuses at the same time.

Robert Craig - Stifel Nicolaus - Analyst

Okay, that's very helpful. Secondly, I was wondering your success in attracting California students, and just how much effort you are placing there at the moment?



Brian Mueller - Grand Canyon Education, Inc. - CEO, President

We are placing significant effort there. We are running a very significant advertising campaign around our traditional ground campus, because the UCsystem, the CU system is really struggling. And really good students with 3.6 and 3.7 GPAs are having a difficult time getting access to programs there.

So they are finding what we are offering at Grand Canyon to be attractive. And so there is a significant amount of work that we are still doing to get California students for the fall of this year. But it is having an impact of the growth of our on-line student body in California.

I can't tell you what the number is right now, but in the last 12 months typically when our overall growth rate has been 12%, 13%, 14%, our growth rate in California has been closer to 30%, and so the impact of having a presence there for traditional students is flowing into increasing the number of working adult students that are coming.

Robert Craig - Stifel Nicolaus - Analyst

That's helpful. Last one, and I will turn it over. Thank you, folks, for the additional break out of SG&A, but within admissions how much is staffing growth? Are you growing the admission staff at the moment or staying fairly flat?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

It is pretty -- it is staying flat, and that's another very positive sign for us. The brand of the institution is growing, and so we are having -- we are able to keep that staff very stable. If we increase it all, it would be 2% or 3%, but right now we are not having to.

Robert Craig - Stifel Nicolaus - Analyst

Great. That's very helpful. Thanks, guys.

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Thank you.

Operator

Your next question comes from the line of Jeff Volshteyn with JPMorgan.

Jeffrey Volshteyn - JPMorgan Chase & Co. - Analyst

Thank you for taking my question. I'm going to ask about the guidance for second quarter. It is one of those things where no good deed goes unpunished.

We appreciate the quarterly guidance, but it but it only went up a little bit on revenues. You didn't adjust EPS guidance. Is there an offsetting expense, or is it just conservatism on your part?



Brian Mueller - Grand Canyon Education, Inc. - CEO, President

I think part is conservatism. Part is we are comfortable with our margin expectations that we previously set. When you do the math, and you leave the margin where we had but add the additional revenue just from a -- with a weighted average share number, it doesn't change the EPS at all because of rounding. And so I agree part is a little bit of conservatism, but part of it is we are very comfortable with the margin targets that we had previously set and chose not to bring that up.

And I -- again I want to point out that one of the things on a year-over-year basis that we have to be cognizant of is bad debt. We got almost a 100 basis point margin expansion last -- second quarter of 2012 because of the collections of previously written-off receivables in the second quarter.

And so that's -- we are hopeful that our bad debt we continue the trends we have seen and end up lower where we are guiding it to right now, butwe are not prepared at this point to bank on that.

Jeffrey Volshteyn - JPMorgan Chase & Co. - Analyst

That makes sense. And on campuses, your expansion in the Southwest area, does that pretty much -- is that going to keep you busy with campus activities, and is there conversation about other geographic areas? Is that out of the question in the near term?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

In the near term, yes. We are going to focus on the Southwest. The markets are very identical in the major cities in the Southwest.

Major presence of a state university, but not really much in terms of private universities. So that gives us -- it makes sense to be there, plus our brand resonates in the Southwest, and there is just plenty of room to grow many years out just by staying here.

Jeffrey Volshteyn - JPMorgan Chase & Co. - Analyst

Thank you so much.

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Thank you.

Operator

Your next question comes from the line of Adrienne Colby with Deutsche Bank.

Adrienne Colby - Deutsche Bank - Analyst

Hi, thanks for taking my question. I was wondering if you could update us on how to think about your marketing as you move more into Division I athletics?

Are you going to be changing your lead sources or some of the target markets that you go to, and how we should be thinking about that into the fall and then 2014?



Brian Mueller - Grand Canyon Education, Inc. - CEO, President

No, it really won't impact anything short-term. I think it will give us a lot more visibility. We are talking about TV contracts right now.

Mostly regional TV contracts, mostly around our men's basketball program, butwe are going to be on the Pac-12 network because our soccer team is playing Stanford to open the season next year.

So there is going be without question an increasing amount of exposure because of our athletics program. But its impact on our marketing spend right now would be negligible. We will just see how far it goes three, four years out, but right now it won't have much of an impact on what we are doing.

Adrienne Colby - Deutsche Bank - Analyst

Thanks. And I think this time last year you said you had about 3,600 students registered for the fall class. Could you update on where are you at this year?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

We are -- you know our target for the ground students is 4,000, and we are on track to do that and maybe exceed that some. We actually built two dorms instead of one, and those dormitories may be full.

In fact, there might be a shortage of rooms. And so the ground campus strategy for this year is really going better than expected.

Adrienne Colby - Deutsche Bank - Analyst

Thank you.

Operator

Your next question comes from the line of Jeff Mueller from RW Baird.

Jeff Meuler - Robert W. Baird & Company, Inc. - Analyst

Good afternoon. On the overall starts number, I know that this is consistent with what you are guiding to, but within the higher quality programs like Health Sciences and Education are you seeing deceleration, and if so are you also governing that rate to the highest quality students within those two verticals, or how should we think about that?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

No, decelerate. In fact, in the really important programs things are accelerating. So our doctoral student number is up. Our Masters in Nursing program numbers are up. Most of our master degree programs are up, even as a percentage.

The only one that is down a little bit as a percentage is the Masters in Education. It is up in terms of a raw number. It is down in terms of a percentage. But that is the one we we've been telling people is very competitive.



Every place else and even at the baccalaureate level, our RN to BSN program is way up, both in raw numbers and as a percentage. And those students behave very like master degree students from a graduation rate perspective, from a cost to acquire perspective. And so for the most part to grow the on-line campus with good students in the programs that we are targeting is going as planned.

Jeff Meuler - Robert W. Baird & Company, Inc. - Analyst

Okay. And then if I heard you correctly I think you said you expect retention gains that you have been making to level off in the back half? If you are continuing to enroll higher quality students in the programs with the higher retention, and you are continuing the shift toward full time faculty for the on-line classes, why should that level off? Is there some counterbalancing force that offsets those factors?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

No, you just start to wonder how high it really can get. We are starting to get into the high 80s and low 90s on a sequential implied retention rate perspective, and so the question is where can that go? And so again from a conservatism standpoint what we are modeling is that levels off in the second half of the year.

Jeff Meuler - Robert W. Baird & Company, Inc. - Analyst

Okay. And then just finally, last quarter you guys had thrown out I think closer to a handful of potential cities to open the commuter campuses in. It sounds like you have narrowed it down to East Valley and Tucson, at least to start out. Just wondering if you could give some color on what made you choose the East Valley and Tucson, at least for round one?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Just our presence and the growing strength of our brand in the state. And it is the easiest, safest way to go at the onset. Albuquerque and Las Vegas are actively engaged in working with us, and they would really like us to have a presence in their cities.

And so we are continuing to work with the, and I think eventually it is a possibility that we will end up in both of those cities as well. But in the short-term we are going to focus on getting started in the Arizona cities, and then once we've gotten that where we want it, then probably move forward.

Jeff Meuler - Robert W. Baird & Company, Inc. - Analyst

Okay. Thank you.

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Thanks.

Operator

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



Jeffrey Silber - BMO Capital Markets - Analyst

Thanks so much. I wanted to shift gears a bit and talk about the regulatory environment. I know, luckily, it has not been an issue for your Company, but if I remember correctly you were about to make a visit down to DC after the last call. Can you just update us on some of the conversations you had there? Thanks.

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

It was mainly information. There is a -- this -- what we are doing is so different than what is going on in most of the private for-profit education sector, that wethought it was important to make sure we got around and talked to as many people as possible, given that higher ed [read] authorization act is up, and there's a lot --there's some discussion forming around it.

Generally speaking the discussions went well. We've really, really focused on inviting people to visit campus, because whenthey visit our campus they see our investment in classrooms and in laboratories and in technology. And when they talk to our students and they realize that the average incoming GPA is 3.5or a little higher, they spend time with the faculty, they begin to realize that the investments we are making in higher ed are going to have a tremendous impact in the state of Arizona and in the Southwest.

And there is a way to offer -- people keep saying to me why are you making these investments in buildings and laboratories and classrooms? And isn't this thing going the way of technology? What I say to them is the residential experience for traditional students is more important than it has ever been, and if you come down and visit our campus, you will realize that.

It's just that is not sustainable at \$50,000 a year. But when they come down and realize that our students are getting the experience at \$7,800 a year and \$6,500 for room and board, then they begin to understand why it is so important to get behind this.

The governor, the two state senators and all of our local politicians are visiting campus frequently. And they walk around and they say hundreds of Latino students from our immediate neighborhood on our campus going for very, very low tuition rates. And it has an impact on their perception of us as an investment -based or for-profit institution.

So we are trying to get people to understand that this can be a winning proposition for everybody involved. That students can get very low tuition, high quality education. It can be at no expense to the taxpayer, and our investors can get a reasonable return, and that formula is possible.

And so that was mostly a discussion-based thing, and a lot of questions were answered, and I think it helped people realize that there is a model out there that can work.

Jeffrey Silber - BMO Capital Markets - Analyst

That's great to hear. You had also discussed earlier about some expansion or moving into degrees around the STEM area. Are you planning a major investment in that area, and what do you think that will cost?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

There will be some expense from a capital perspective. We've got that already inserted into our CapEx expenditure plans. We are spending a lot of time with some very high quality engineering programs in the high schools in our area, trying to understand the outcomes that they are currently achieving in those programs, and then we want to build on those programs in the engineering and the technology areas as we developed them at Grand Canyon.

We want to develop a program that is very, very meaningful, but it is one in which it is integrated with what is going on in the secondary schools so that we can get students out -- and get them educated and get them out in the workforce for as little money and as a short a time period as



possible. And so starting with a blank slate we think we have a chance to do that. There will be some CapEx investment, but it is not -- it's already built into what our plans are.

Jeffrey Silber - BMO Capital Markets - Analyst

All right. Great. If I can sneak in one numbers question, Dan, just so I understand the reclassification on the income statement side, you took the old selling and promotional line item and basically broke it into three buckets, is that correct?

Dan Bachus - Grand Canyon Education, Inc. - CFO

That's correct.

Jeffrey Silber - BMO Capital Markets - Analyst

And are we going to get the quarterly breakout from last year? Is that --I haven't had a chance to look at the queue. [Is that going to be in writing?]

Dan Bachus - Grand Canyon Education, Inc. - CFO

Yes, it is all in the 10-Q already.

Jeffrey Silber - BMO Capital Markets - Analyst

Okay, great. Thanks so much.

Operator

Your next question is from the line of Tim Connor with William Blair.

Timo Connor - William Blair & Company - Analyst

Thanks, guys. On the engineering/IT programs, and I know you just started to get into it a little bit, but what types of degrees, what types of specific programs and then the jobs that these graduates would eventually fill? How do you imagine that now?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

We really haven't decided on which programs, particularly in engineering. We are forming an advisory committee that will consist of high level, C level kinds of people from the major companies, major industries that exist in the Southwest. And it is going to be from that advisory committee, those meetings and what's going on --

We are going to take some people in the secondary school system in Arizona and make them part of the advisory committee so that we we're making sure that we tie together the efforts of the secondary school system and the efforts of the industries in our local economy. We want to be in the middle of those two and help tie those together. So haven't really decided on the specific programs yet, but I would say within six months we probably will.



Timo Connor - William Blair & Company - Analyst

Okay, thank you. In on-line has the mix of lead sources changed recently? You mentioned being a little bit more selective on the program side. Where is the mix of lead sources right now, just broadly, and then how does that compare to where it was a few years ago?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Organic searches are really going up. So between -- and that's being driven primarily by the TV ad campaigns and the other out reach efforts on our campus. And so more and more we are moving in a direction of traditional media. and using the brand of -- the other branded programs that we have on our campus to drive organic searches so that we are less dependent on the lead aggregators. And so we haven't broken that out from a percentage standpoint, but it's going in a direction that we want it to.

Timo Connor - William Blair & Company - Analyst

Thank you, appreciate it.

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Yes.

Operator

Your final question comes from the line of Trace Urdan with Wells Fargo.

Trace Urdan - Wells Fargo Securities, LLC - Analyst

Hi, good afternoon. I wanted to start asking -- this is following up on Jeff's question about the new programs. Can you, give us a sense of what kind of timing we are looking at there, and are you looking at rolling those programs out both on-line and on ground, or willthere be a staged rollout?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

From an engineering standpoint we are looking at sometime in 2015 if everything would go well. And we are looking primarily at ground programs. I think there are some IT programs that we could deliver on-line, but the engineering programs will all be on ground.

Trace Urdan - Wells Fargo Securities, LLC - Analyst

And I know that there was some talk awhile back about your religious studies program. I wonder if those were commenting on the growth trend there and whether that program has any potential to move on-line?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Yes, it does. We have a newly formed college, the College of Theology. We moved it out of the liberal arts school, out of the Liberal Arts College.

And we are looking for a dean. Once we have located a dean, we are in the process of building out programs, but that will be accelerated. In fact, we will have a Masters of Divinity program here at some point.



And so the potential for the College of Theology is much greater than what we are currently experiencing. But it is kind of by plan. We want to get a dean in place and put together a strategy with that person in place. And then we will be a little more aggressive about marketing that.

Trace Urdan - Wells Fargo Securities, LLC - Analyst

Okay. Very good. And then two more questions. Do you guys have any -- or how many international students do you have, if any? And do you do anything from a marketing standpoint to try to attract international students to the ground campus?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

Good question. We have been asked about that a lot. We don't currently do much from that standpoint. There are certain countries that have large populations of -- a growing Christian population that are looking for Christian universities. South Korea would be one in particular.

That's something we will take a look at. We don't have any strong reason to move in that direction immediately, but from future perspective, we will probably look at that. It is a natural for what we are doing, but there is really no need for us to do it in the short-term.

Trace Urdan - Wells Fargo Securities, LLC - Analyst

I'm pretty sure I know the answer to this question, but I will ask it anyway. A bunch of schools that do have a substantial amount of traditional high school students coming in I think are meeting with a fair amount of resistance from high schools at the moment because of the negative publicity that has surrounded the sector. I'm wondering what your experience has been in terms of being able to make presentations or speak to high school students?

Brian Mueller - Grand Canyon Education, Inc. - CEO, President

No, that -- most of that is not impacting us at all. We -- when we get students on campus, families on campus, and when we get high school guidance counselors and even assistant principals and principals on campus, and we give them campus tours, and they look at the potential of their graduates coming here and studying in really state of the art brand-new laboratories -- and 50% of the students are studying in the hard sciences. We have the state's largest cadaver lab.

And so when they think -- when they look at the new laboratories, the new classrooms, the brand new dormitories, the new eating facilities, they get very excited about the potential ease, especially when they realize they will get this with an average class size of 20 students for on average of \$7,800 a year. So the word about that is spreading rapidly, and with all of the challenges that are being faced by state university systems, this is becoming an attractive option. What we have to do is simply get them on campus.

Typically a middle class family or lower middle class family will automatically dismiss the possibility of being able to go to a private university because it is not affordable. When they realize how affordable this is, the word spreads through schools pretty rapidly. We have a school here, Valley Christian High School, who had 90 students in their graduating class last year, and 60 of those students came to Grand Canyon. We have other Christian schools who are literally 50% of their graduating classes are coming here.

And so we have not experienced much of that at all.

Trace Urdan - Wells Fargo Securities, LLC - Analyst

Great. And the state's largest cadaver lab, I think you may want to put that higher in your investor presentation.



Brian Mueller - Grand Canyon Education, Inc. - CEO, President

It is interesting, when I give campus tours I always ask if people would like to stop in, and most of the time I get a negative response to that. But interestingly enough, we have a science day here for high school students, and we get up to 4,000 students that come. And the biggest reason they come to that science day is because they want to be into that lab. Most undergraduate science programs don't allow students to really have access to a cadaver lab, and wewant to get them started with those dead people as early as possible.

Trace Urdan - Wells Fargo Securities, LLC - Analyst

Excellent. All right, thank you.

Brian Roberts - Grand Canyon Education, Inc. - General Counsel

We have reached the end of our first quarter conference call. We appreciate your time and interest in Grand Canyon Education. If you still have questions, please contact myself, Dan Bachus or Bill Jenkins. Thank you very much.

Operator

Thank you. This does conclude today's conference call. You may now disconnect.

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