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Conference Call Transcript

APOL - Q3 2009 Apollo Group Earnings Conference Call

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PRESENTATION

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Operator

Good afternoon ladies and gentlemen, and welcome to Apollo Group Inc. fiscal 2009 third quarter earnings conference call. At this time all participants are in a listen-only mode. Later we will conduct a question-and-answer session and instructions will follow at that time. (Operator Instructions). This conference call is being recorded today, June 29, 2009, and may not be reproduced in whole or in part without permission from the Company. I would now like to turn the call over to Allison Pooley, Vice President Investor Relations of Apollo Group. Ms. Pooley, go ahead, please.

Allyson Pooley - Apollo Group - VP IR

Thanks. Thank you, everyone, for joining us today. Speaking on our call will be Chas Edelstein, Co-Chief Executive Officer; Greg Cappelli, Co-Chief Executive Officer and Chairman of Apollo Global; and Brian Swartz, our Senior Vice President, Chief Financial Officer and Treasurer. Joe D'Amico our President and Chief Operating Officer is also here with us and will be available during the Q&A period.

Before we begin, I'd like to remind you that as we discuss our results we note that unless otherwise stated we will be comparing our third quarter of fiscal 2009 which ended May 31, 2009, to the third quarter of fiscal 2008. I would also like to remind you that this conference call may contain forward-looking statements with respect to the future performance and financial condition of Apollo Group that involve risks and uncertainties. Various factors could cause actual results of the Company to be materially different from any future results expressed or implied by such forward-looking statements. These factors are discussed in item 1A and elsewhere in the Company's most recent 10(K) report and in subsequent 10(Q) reports filed with the Securities and Exchange Commission. The Company does not undertake any obligation to update anyone with regard to the forward-looking statements made during the conference call. With that I would like to turn the call over to Chas.

Chas Edelstein - Apollo Group - Co-CEO

Good afternoon, everyone. Thanks for joining us today to discuss our third quarter results. We reported another record quarter and are particularly pleased to have surpassed the \$1 billion quarterly revenue mark for the first time. Today I'll provide you with some highlights from the quarter and Brian will then review our financial results in more detail. Lastly, Greg will touch on certain regulatory items and provide an update on some of the important operational aspects of the business.

We continue to enjoy the benefits from the investments we've been making in key academic and operating areas, which drove 26% revenue growth and a 48% EPS growth in the third quarter. The primary drivers of the revenue growth were higher enrollment and the benefits of the 2008 increased tuition rates at University of Phoenix. Degreeed enrollment at University of Phoenix contributed about 22 points of that total 26% revenue growth and higher tuition rates accounted for the balance. Total enrollment growth at University of Phoenix was driven by continued strong new degreeed enrollment growth of approximately 23%. Additionally given our focus on the student experience, we are very pleased to report continued year-over-year improvement in retention at each degree level.

Going forward we are going to continue to focus on the big things. Number one, access to high quality education. We are providing access to high quality education for greater numbers of students. Number two, quality people. We are hiring and retaining high caliber faculty members and staff and giving them the tools necessary to execute and succeed. And number three, best in class systems. We're focusing on building and maintaining best in class systems and processes to support the delivery of our educational products, compliance and risk management.

We believe these are the critical elements necessary to generate successful long-term growth and attractive returns for all of our stakeholders and our results this quarter are testimony to our continued progress therein. With that let me turn the call over to Brian to discuss our financial results in more detail.

Brian Swartz - Apollo Group - CFO

Thanks, Chas. Our strong results this quarter were driven by increase in revenue of nearly 26% to just over \$1 billion compared to \$835 million for the same period a year ago. Again, the components of this increase were primarily University of Phoenix's 22% enrollment growth and increased tuition rates.

Net income for the third quarter excluding the securities litigation charge a year ago increased 44% to \$201 million resulting in diluted EPS of \$1.26. About \$0.02 of our earnings this quarter came from a lower share count due to stock repurchases which I'll discuss in a moment.

Operating income excluding the securities litigation charge a year ago, increased almost 51% to \$336 million, and our operating margin expanded a healthy 520 basis points to 31.9% from 26.7% a year ago. This increase, as a percentage of revenue, was driven by a 350 basis points improvement in instructional costs and services or ICS, a 120 basis points improvement in selling and promotional expenses, and a 50 basis points improvement in general and administrative expenses or G&A.

I'll spend a minute on the drivers of improvement in each of these expense categories.

First, ICS which increased about 15% year over year but declined 350 basis points as a percentage of revenue to 38.1% from 41.6% a year ago. The significant improvement here was driven primarily by economies of scale associated with our 26% increase in revenue as well as continued savings from lower negotiated contract costs with third party vendors, particularly in the area of financial aid processing where costs declined significantly year over year despite an increase in volume.

Offsetting some of the improvement in ICS were two factors. First, start up costs at Apollo Group and second higher bad debt expense. Bad debt expense increased 100 basis points to 3.4% of revenue compared to 2.4% a year ago. The year over year increase was primarily due to the increased aging of receivables and the related risk of collecting them, coupled with lower collection rates of older receivables. Consistent with past quarters our total allowance for doubtful accounts continues to exceed all receivables greater than 90 days old.

It is important to note that over time we have the ability to exercise significant control over our receivables and bad debt levels. For example, we control the timing of when a student begins class relative to our loan certification process. We periodically review this type of item and make judgments balancing the business opportunity and receivables risk. We are comfortable with our current bad debt levels.

Moving to selling and promotional expense which increased approximately 20% year over year but as a percentage of revenue declined 120 basis points to 23.2% from 24.4%. This is the second quarter in a row we have seen a decline as a result of more effective marketing spend as well as continued improvement in enrollment counselor effectiveness.

Finally G&A. G&A expenses increased just over 17% to \$71.5 million, yet as a percentage of revenue declined 50 basis points to 6.8%. The improvement as a percentage of revenue is primarily due to the continued leveraging of relatively fixed employee compensation cost over higher revenue. As we look forward we want to remind you that in the fourth quarter of 2008, we had abnormally low G&A cost due to executive management departures which led to lower than expected compensation expense including share-based compensation.

On the subject of share-based compensation during the third quarter we recorded approximately \$18 million. We now expect to record approximately \$70 million for the full year. This is slightly below our prior estimate. With respect to income taxes, during the third quarter our effective tax rate was 40.9%. Due to higher state taxes and an increase in certain non-deductible losses, we now expect our tax rate for the full year to be approximately 41%; slightly above what we had previously forecasted.

Now let me turn to the balance sheet and cash flows. We continue to maintain a well capitalized balance sheet with cash and marketable securities, excluding restricted cash, at the end of the quarter totaling \$819 million versus \$511 million at August 31, 2008. We generated approximately \$312 million of adjusted free cash flow during the third quarter, a 34% increase year over year. As a reminder we define adjusted free cash flow as cash flow from operations less CapEx and changes in restricted cash.

I'd like to note that last week we funded an escrow account for \$550 million related to Apollo Global's previously announced proposed purchase of BPP, which lowers our currently available cash and liquidity. We expect a portion of these escrow funds to be released shortly after the closing of the deal. During the third quarter we repurchased approximately 7.2 million shares of Apollo stock at a weighted average price of approximately \$62 per share for a total expenditure of \$444 million out of our prior \$500 million authorization. Our Board recently brought that authorization for share repurchases back to \$500 million and we will continue to evaluate future share buybacks in addition to other investment opportunities. With that I will turn the call over to Greg.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Thanks, Brian. Today I'd like to address several key topics and touch on some of the questions we know are on your mind. First, I'll discuss certain government regulatory issues. Second, provide an update on a couple of our investment areas. And, third, discuss recent tuition changes and give you our thoughts on the business as we finish the year. I'll start with addressing government regulation. There's three topics here I want to touch on.

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First, the current administration, second, the 90/10 rule, and third our focused program review. Since the Obama administration took office in January there's been a heightened concern in the investment community about regulatory issues. This administration is very focused on education reform and has set many positive objectives, many of which align with our vision of providing access to high quality, affordable education to as many students as can benefit. In recent years, University of Phoenix has taken a leadership role in providing a very transparent view into the learning outcomes of our students. We are in the process of preparing our second Academic Annual Report, which should be available in September. It will provide more data on student performance, student satisfaction, completion rates, and how we are faring in achieving our mission of accessibility, diversity and inclusion in underrepresented populations.

Apollo Group has over 30 years of experience working with many different administrations, accrediting bodies and departments of education in numerous states. We therefore have a high degree of confidence in our ability to meet our students' needs in changing regulatory environments going forward. Now let me discuss 90/10. As you know this is a rule that applies only to proprietary schools. Due in large part to the loan limit increases put in place over the last couple of years, University of Phoenix's percentage of revenue that has come from Title IV continues to trend up. We've been carefully monitoring the impact of the increased loan limits on the University of Phoenix's 90/10 calculation and continue to take action including emphasizing employer-paid and military programs, encouraging students to carefully evaluate the amount of Title IV loans they're taking and increasing our focus on professional development and continuing education.

We are required to report our 90/10 calculation annually and while we can't perfectly predict at this point where this calculation will come out, based on our most current information we do expect the rate for the University of Phoenix to approach but not exceed 90% for fiscal 2009. Again, it's an area we continue to monitor closely and, of course, we will update you when we report next quarter as to exactly where the rate comes out after completion of our fiscal year.

Next, I'd like to give you an update on our focused program review which you'll remember took place in February this year. We've been very responsive to the Department of Education's requests and we believe they are making progress in finalizing the report. We hope the review will be completed in the next few months.

I'd now like to touch on a couple of our investment areas, specifically marketing and Apollo Global. As a reminder, we evaluate all potential investments in a pyramid type priority structure. The University of Phoenix is on the top because of its superior returns and therefore we continue to reinvest first and foremost in the numerous growth and quality initiatives within the University of Phoenix. We are also planting the seeds for future growth by investing additional resources in our other businesses such as Apollo Global and Western International, to name a few. We also look to invest in Apollo Group stock through share repurchases, in which, as discussed earlier, we were very active during the quarter.

On the marketing front, we acquired Aptimus almost two years ago to bring our marketing capabilities in-house. We had two key objectives when we made the purchase. First, more effectively target students who would retain at a higher rate and acquire them at a lower cost and, second, to take back control of our brand. I'd like to update you on both.

During the quarter we experienced very strong new and total enrollment growth. We believe the strategic marketing initiatives that we're implementing including the continued move to more direct advertising, are producing better quality student inquiries and resulting in higher conversion rates. We also continue to see growth in transfers from our associates program to our bachelors program, while the pool of associate graduate and thus potential transfer students continues to grow.

During the third quarter we continued to increase our marketing spend on brand building. We rolled out our "I am a Phoenix" campaign nationally in part, to instill a sense of pride within our student body and to leverage our large alumni base. Additionally, we continue to expand advertising in local communities to drive long-term brand and reputation awareness. We believe these efforts are very important and key to our future success in establishing our Company in the consumer's mind as the premier provider of accessible, high quality education.

Another area we think improves our position and advances our mission is to more deeply partner with large Fortune 500 type companies. We are also enjoying some good progress in our strategic accounts group. This group partners with our target companies by customizing solutions to address the Company's specific academic needs. Our efforts are in the early stages but we are quite pleased with the results thus far.

Now an update on Apollo Global. As a reminder Apollo Global is a \$1 billion joint venture formed in 2007 between Apollo Group and private equity firm, The Carlyle Group. Apollo Global's mission is to advance access to quality global education by investing in institutions respected in their academic communities led by visionary leads and driven by innovation.

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In early June, Apollo Global announced its intent to acquire BPP Holdings for 620 pence per share in cash. That represents an enterprise value of about \$540 million at the time of the announcement. Now, since then we've entered into a hedge agreement to limit our currency risk. The transaction is structured as court sanctioned acquisition arrangement under U.K. laws and is subject to court, shareholder and regulatory approval. Assuming receipt of the necessary approvals we expect to close around August 1.

BPP is a leading provider of education and training to professionals in the legal and finance industries and is the first private sector institution to have been granted degree awarding powers in the UK. The acquisition will provide Apollo Global with access to lifelong learning, programs in the UK's professional education sector, establish a significant U.K. and Pan European platform and expand the range of advanced degrees and cross border educational opportunities available to its students. We are excited at the prospect of joining forces with this outstanding company.

Now let me just talk to you on recent tuition rate changes. We recently announced University of Phoenix's 2009 tuition and fee changes which will be effective in a few days on July 1. In aggregate, the tuition and fee changes average about 4%. This includes higher discounts to our military and veteran students as well. The rate at the associate degree level increased approximately 6% and the rates at our bachelors and graduate levels prior to the discounts I just mentioned increased about 3 to 5%. As a reminder discounts in the fourth quarter generally are higher than the rest of the year because we allow students to prepay for courses at the old rate. We record the pre-pay as a discount. Additionally, the increases in military and veteran discounts can lead to higher levels of discounts going forward.

So in conclusion the third quarter was a continuation of the strong performance we have seen this past year. We've been making investments over the last couple of years and we are experiencing the benefits. We continue to see opportunities in front of us that cause us to be very excited about the future of the Company. We are committed to balancing our growth with our mission to provide access to a quality education and experience for students. As we move forward, the primary operating metrics for the fourth quarter continue to look strong on a year over year basis and we continue to manage the business for solid growth and cash flows for 2010 and beyond. As always, we want to thank our thousands of employees and faculty who work so hard to deliver high quality education to all of our students every day. With that, I will turn the call over to the operator so we can take your questions. Thank you .

QUESTION AND ANSWER

Operator

(Operator Instructions). Your first question comes from the line of Sara Gubins from the Bank of America Merrill Lynch.

Sara Gubins - BAS-ML - Analyst

Hi, thanks. Good afternoon. Last quarter you mentioned if growth continued at the different rate that you would probably need to increase the hiring of academic counselors, enrollment advisors and financial aid advisors. I'm wondering if you've begun to do this and what your plans are.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Okay. We are always looking at the rate at which we need to add ECs, ACs, and financial counselor and we've been adding them appropriately. As far as adding them at a greater rate I don't think that's something we are doing right now, Sara. We feel comfortable at the levels they've been at and while we do continue to add to them it's not at an outpaced rate of growth at this point.

Sara Gubins - BAS-ML - Analyst

Were there any costs that you expected to incur in the third quarter that were deferred to the fourth?

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

No, not that I can think of.

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Sara Gubins - BAS-ML - Analyst

Then last question. You had given some broad guidance about your longer term growth expectations a couple of year ago and I'm wondering if you could provide any update to that?

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

We do plan to update you after our fiscal year ends because we know we've been outperforming those metrics at a considerable pace and so we'll like to complete the fiscal year end, we are getting through the budgeting process obviously and we'll have an update for you on the conference call next quarter.

Sara Gubins - BAS-ML - Analyst

Okay. Thanks very much.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Sure, my pleasure.

Operator

Your next question comes from the line of Mark Marostica from Piper Jaffray. Your line is open.

Mark Marostica - Piper Jaffray - Analyst

Yes, thank you. My first question relates back to Sara's point on hiring plans. And I'm curious, I know you're not giving specific guidance or anything along those lines on enrollments but if you could frame for us how you think about controlling or looking at start growth over the coming quarters now that it's your coming up against the first tough comp on starts in the upcoming August quarter and also looking at certain hiring targets, any color there on how you frame that?

Joe D'Amico - Apollo Group - President, COO

This is Joe D'Amico, Mark. Yes, we look at managing the new enrollment growth and trying to maintain consistent growth. Also we look at obviously our advertising spend in that light as well. We've been managing to make sure our spend is commensurate with the expected start growth. We realize that as accounts get more difficult that it may be a little tougher to get to levels that we are looking for. But so far we've been doing very well and all indications today anyway are that we expect our growth to continue at levels consistent with where we've been.

Mark Marostica - Piper Jaffray - Analyst

Then one follow up on Greg's remarks concerning 90/10 I understand you are approaching that 90% level, are you planning to alter your selection criteria in any way, shape or form as you look at incoming students?

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Mark, we are doing a number of things that I mentioned in my remarks including focusing on building more of our corporate business and our military business and just educating some of our students on whether they need as much financial aid as they currently take out. As far as the selection criteria, we are continuing to work on some pilots; looking at certain criteria. I would not tell you that it would be something that would have a meaningful impact any time soon. We are looking at some different initiatives there now but not just as it relates to 90/10, as it relates to making sure that we are accepting the students that can really benefit from University of Phoenix and our system going forward.

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Mark Marostica - Piper Jaffray - Analyst

Okay. Thank you.

Operator

Your next question, Suzi Stein from Morgan Stanley.

Suzi Stein - Morgan Stanley - Analyst

Thank you. You seem to be doing very well in the bachelor degree area in terms of enrollment growth. Can you just address this a little more? I know you've mentioned that some of this is coming from the associate programs but can you maybe break that down a little and just talk about any targeted efforts that you have along those lines.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Sure, Suzi. We are really pleased with what we are seeing from our associates to bachelors levels. I think that is paying dividends for us. And we are trying to encourage those students to go on to get their bachelors programs. We will tell you the majority of the increase in bachelors enrollment growth still is outside of that transfer from the associates to the bachelors level and we are pleased with that as well. We haven't yet started to see the benefits I don't think of a targeted campaign just a bachelors or even masters students just yet. We are refining that now. We do plan doing more of that in the future quarters ahead. And you will hear us talk more about that going forward. It's about as much detail as I can give to you right now on the subject of bachelors enrollment growth.

Suzi Stein - Morgan Stanley - Analyst

Can you give us any update on your thoughts as far as transitioning to direct lending, any expenses in what you are putting in place now?

Brian Swartz - Apollo Group - CFO

Suzi, it's Brian. Yes, we are on track to certainly comply as necessary if the government goes in that direction in July of 2010. We will be rolling it out here as an option for certain loan programs on July 1, 2009, so we have no concerns about meeting any deadlines the government might put in place.

Suzi Stein - Morgan Stanley - Analyst

What about any costs though associated with that, how significant do you expect that to be?

Brian Swartz - Apollo Group - CFO

Not significant based on our current plans.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

We've been doing, as you can imagine research in this area, making sure the software is in place, looking at costs, checking with other institutions that have already been through it and that's why we feel comfortable giving you the answers that we have.

Suzi Stein - Morgan Stanley - Analyst

Okay. Thank you.

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Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Thank you.

Operator

Next question, Andrew Steinerman from JPMorgan, your line is open.

Andrew Steinerman - JPMorgan - Analyst

Hi, there, it's Andrew. In the quarter the margin was 32%, this is just an individual quarter but it is one of the highest margins the Company has seen in a good period of time. Could you just talk big picture over the intermediate term, do you feel like there's margin expansion over the intermediate term from these levels?

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Andrew, I think that in the fourth quarter we are comfortable telling you that there's going to be -- there should be significant margin expansion again, can we pinpoint the exact level for you, no, but we are comfortable with the direction we are seeing. Obviously some of that is going to depend on if you look out longer term into how successful we are with Aptimus, how successful we are in our cost initiatives at the University of Phoenix as well as Apollo Group in general, how aggressively we invest in some of the other businesses that we are talking about including global. We are trying to balance that now and do think that our margin will see some expansion in the fourth quarter as well.

Andrew Steinerman - JPMorgan - Analyst

Right. And my question is more intermediate term.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Let me add one more thing, too, I know we've said this before, it really is not how we manage the business, we are not managing to a certain target. We are managing for operating and cash flow growth going forward and the margin will be what it is.

Andrew Steinerman - JPMorgan - Analyst

Let me just slip in one part to the question. A costs per starts coming down year over year two quarters sequentially or longer, do you think costs per start is at a level that can be sustained, improved or does it have a bias upwards?

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Our goal is to continue to try and see improvements there. We have seen significant improvements in the cost to acquire a student. Again, some of those are initiatives that we announced we were taking over a year ago that were paying dividends. That's like going more direct than through the third party affiliate channels and that's having an impact. There's other initiatives as well that we hope will continue to drive that at least to the current levels and maybe lower. Some of that's going to depend as you know on the overall advertising environment as a whole.

Andrew Steinerman - JPMorgan - Analyst

Okay. Sounds good. Thank you.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

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I will add one other thing as well. And that is when you look at our advertising spend or just the cost in general, the majority of the increase this quarter is coming from our long-term brands building initiatives. That we are focused on right now.

Operator

Your next question comes from the line of Gary Bisbee from Barclays Capital, your line is open.

Gary Bisbee - Barclays Capital - Analyst

Hi, guys, good afternoon and congratulations on the quarter.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Thanks, Gary.

Gary Bisbee - Barclays Capital - Analyst

A couple of questions. You haven't said a whole lot to date about strategic rationale and how excited you are about this BPP transaction. Can you give us some sense what are the highlights that you see and how big this opportunity may be?

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Gary, part of the reason for that is because legally there's only so much we can see before a transaction hopefully closes like this. We are very excited about it. As I mentioned in my comments this was an opportunity for us to establish a significant U.K. presence with a tremendous brand in the U.K. They have the right as a for profit to grant degrees which is very important to us as well and potentially will be an opportunity for us to go into the rest of Europe. So we are looking, I won't discuss the strategy for BPP on this call but I can tell you that there's a terrific management team that we've known for awhile running the business and we see a lot of opportunity for us to take things that we've learned here over the past 30 plus years and help this organization to be a much more significant player not only in the UK but in other parts of the world.

Gary Bisbee - Barclays Capital - Analyst

In any sense how much you would likely look to increase investment in the business? I mean it seems to me you could spend a whole lot relative to what they've been spending of incremental growth investment and it wouldn't be a huge deal for you. should we expect the big.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

I think that we will look to invest in the business, absolutely, to do some of the things that we just talked about but I think you are also right that as a consequence to Apollo Group that it will not be, you will not look at that investment as having a material impact to Apollo as a whole.

Gary Bisbee - Barclays Capital - Analyst

Okay. Then just the comment around setting aside the \$550 million in escrow, is the minority owner here, is Carlyle, are they going to chip in money or might you borrow money? Any sense on how to think about financing.

Brian Swartz - Apollo Group - CFO

It's Brian, the escrow we set up was basically required under UK take over rules so we would expect on closing and Carlyle has agreed they are absolutely going to fund their share of it to fund it at closing and as a result of that we would expect some of those escrow proceeds to come back

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to us at closing as I mentioned. Yes, Carlyle is absolutely participating. We are excited about that and the escrow was just for purposes to comply with U.K. takeover rules.

Gary Bisbee - Barclays Capital - Analyst

One last question, can you give us any update at all on some of the less talked about growth initiatives where we know you are investing money. Any update on what's going on at Insight, and how you might be positioned in the start of this Fall school year and maybe the Canadian business you started a couple of quarters ago? Thanks.

Joe D'Amico - Apollo Group - President, COO

This is Joe. Both of those are still in the start up mode where we are investing and growing. And we are also doing that on a in a deliberate way. So we want to do it right. So we are not really commenting much further than that at this point.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Same thing with, Gary, you heard us talk about WIU, very excited about the potential opportunities there. Some of the new management that we put in place are already off at a terrific start and we do expect that to have an impact going forward. We will be excited to tell you more about that in future quarters as it ramps up.

Gary Bisbee - Barclays Capital - Analyst

Thanks a lot.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Thank you, Gary.

Operator

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

Bob Craig - Stifel Nicolaus - Analyst

Good evening, everybody.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Hi.

Bob Craig - Stifel Nicolaus - Analyst

I know you want to get away from this but can you give us any idea as to magnitude of increase on percentage terms and ad spend in the quarter, was there anything meaningful change in the composition of add spend? I know last quarter you referred to more off-line spending.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

That's a good question. And we are, the reason why we haven't classified it the exact same way is as the Company grows and we do things outside of just the University of Phoenix and Global and whatnot, those will certainly have impacts but what I would say is as a percentage of

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revenue it was fairly close to what it was last quarter and from a growth perspective although it grew faster than last quarter I'm talking about advertising now even though it grew faster as I mentioned in my comments the majority of that was from the long-term branded campaign. So we are still getting leverage on the average cost to start a student.

Bob Craig - Stifel Nicolaus - Analyst

That's helpful. Thinking back to conversation at the end of last quarter on what to expect in margins on the second half you were emphatic that you wouldn't see the 550 basis points increase you had year to year in the first half and I guess to be fair you didn't quite get there in this quarter but certainly got a lot closer than we thought you would. Is it basically just the business surprised you positively from the standpoint of enrollment persistence, the leverage that creates or were there some other factors there?

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Yes, I think that's right. When you achieve greater revenues in this business than you project you get a lot of leverage and it can go the other way as well as you know. So we continue to benefit from that. We are also, we've been refining our forecasting and investing in our forecasting abilities and that's continuing to improve now as well. And we will talk more about that next quarter as we give out some of our revised thinking in terms of long-term growth targets and whatnot but those are some of the things that we are very pleased to see it. We certainly at the time were not trying to be confusing on the margin but just realistic and it came in better than we had expected.

Bob Craig - Stifel Nicolaus - Analyst

That's helpful. Last one and I will turn it over. Can you comment on the development pipeline, can you quantify it or what are some of the areas of focus there?

Joe D'Amico - Apollo Group - President, COO

Sure, assuming you mean the academic programs.

Bob Craig - Stifel Nicolaus - Analyst

Yes.

Joe D'Amico - Apollo Group - President, COO

We continue to invest in many different areas, one of them, for example, is on the sustainability because it's totally consistent with our objectives. We think it's an area that will be, especially under the Obama administration, will be a hotter area going forward. So we are investing in that area as an example. And we are investing really at all degree levels including our doctoral degree programs and our master degree programs. We are also looking at actually our entry programs to address those programs and create a better student experience, for example. So we are investing throughout the curriculum and have been for awhile.

Bob Craig - Stifel Nicolaus - Analyst

Okay. Great. Thanks, guys.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Thank you.

Operator

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Your next question comes from the line of Amy Junker from Robert Baird, your line is open.

Amy Junker - Robert W. Baird - Analyst

Can you talk just a little bit about given the current administration focus on affordability for programs and desire to limit student debt what your thoughts are on tuition increases going forward? I know you talked about what's going on this year but does that change your thought at all on how you increase tuition going forward?

Chas Edelstein - Apollo Group - Co-CEO

Sure, Amy, it's Chas. I think that as you saw this year, we are not inclined to be overly aggressive in tuition price increases and that's, I guess it's responsive to the administration. It's largely responsive to our students and their needs and that's how we think about it. We look at what's going on in the markets and so our tuition increases vary between modality and region and degree type but it's, it keeps in mind the fact that we are trying to be responsive to our student needs and our mindset is not to be overly aggressive.

Amy Junker - Robert W. Baird - Analyst

Great. And then, Greg, last quarter you talked about increased investments in the learning management system. Can you just talk a little bit about timing and size of those investments?

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Yes, sure, and Joe has been leading that so I will ask him to make some direct comments.

Joe D'Amico - Apollo Group - President, COO

Sure, we are looking at, first from a people perspective and we have made some investments if you will in caliber period to help us guide our direction there and keep us if will you the leading edge on the software development side. Most importantly thinking about how that affects the student experience and making the student experience the very, very best you can get in this industry. So that is sort of the approach. We are not anticipating a major investment that would be sort of in the stair step away. And we expect this to occur over not the course of six months or a period like that but over a longer term period.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

The things that we've seen to this point are to us very exciting because we think it's going to really help reach additional people and help them learn. Hopefully at greater levels.

Amy Junker - Robert W. Baird - Analyst

Great. Thank you.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Thanks, Amy.

Operator

Your next question comes from the line of Brandon Dobell from William Blair. Your line is open.

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Brandon Dobell - William Blair - Analyst

Hi, thanks, Brian a quick were one for you. In your prepared remark you talked about bad debt. Just wanted to understand how to put in context your comments about how comfortable you guys are. Looking at this quarters number or talking about the historical range of bad debt? I want to get a better idea of what you mean by comfortable and how we should thinking about it on a go forward basis?

Brian Swartz - Apollo Group - CFO

Yes, Brandon, it really comes down to when we control the metric. There are things that we could do to drive bad debts down and there are thing that we do that potentially could increase it. If you look at bad debt instead of sequentially but more kind of on a last 12 months an LTM basis over the last three years we've been at the low point of about 3% and a high point of 4.5 each quarter sequentially if you look at it on an LTM basis. Obviously we prefer 11% over 4.5 but we are constantly focusing on managing that number, doing the right thing to -- I'm sorry--.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

You said 11% over--.

Chas Edelstein - Apollo Group - Co-CEO

Strike that from the record, Brandon.

Brandon Dobell - William Blair - Analyst

Stricken, thank you.

Brian Swartz - Apollo Group - CFO

Obviously we prefer 3% over the 4.5 but it is in our control and we monitor and over time we will do what's necessary to make sure it stays in the range that we've comfortable with.

Brandon Dobell - William Blair - Analyst

A related question there, in the press release you talked about a little more efficiencies or just a better process in terms of financial aid processing times. As you guys get better there or perhaps if it changes up a little bit in your favor as you mover to direct lending how do you balance that or how does that feed into the bad debt calculation?

Brian Swartz - Apollo Group - CFO

Yes, you notice that in the day sales outstanding. That impacts receivables but generally current receivable. So the reason why the bad debt is going up, we have more aging receivables now than we did a year ago. We are seeing collection rates on those older receivables come down. If you want to look at it as current receivables versus older receivables. Current receivables are down because of better processing times. And the older receivables we are seeing lower collections and more of those dollars and that's why it's up.

Brandon Dobell - William Blair - Analyst

Got it. Then a broader question, the perceived or perception among investors that we talked to focuses on instructional costs and services as some sort of proxy for educational quality or just the amount of dollars you're investing in the product for student outcomes. Would this be the first real quarter below 40% and obviously great margin leverage there, if someone came to you and said, look, that number is just too low. We don't think you are putting enough back in the classroom, those kind of general comments that we hear from people how would you guys as a management

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team address that perspective or what kind of data can you offer up relative to your traditional peers that would help refute that kind of an argument?

Joe D'Amico - Apollo Group - President, COO

Brandon, this is Joe, boy, that's a great question. First of all the main part of the reduction in cost was strictly a reduced price from getting reduced pricing from an -- getting reduced pricing from an outsourced -- the group that out sources -- that we outsource to on Title IV processing. That in and of itself had zero impact on quality. It was only the price part.

Secondly, we are investing in increased salaries to faculty members. We have 24,000 faculty. We are reviewing them all the time. We are attracting new people, new faculty to the program. Always there's a big backlog. We've invested in training, we invest in the curriculum.

There are substantial dollars that go in that line that do relate to, directly to the quality of the education that our students are getting. But I would also offer to you that a lot of the other things we do that don't necessarily get included in that category are also creating and contributing to the quality of the education. Whether that be in the software that's used in some of the support functions like for example counseling that's done there are a lot of factors that enter into the student experience that we think is really important that are also adding to the quality of the educational product. So most of the gain bottom line has been through price reductions that have had nothing to do to deal with the quality.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

In aggregate you would have seen greater but those are being offset by significant investments we are making into the quality of the student experience.

Brandon Dobell - William Blair - Analyst

Okay. And then final question for you if you look at the other revenue this quarter, so non-degree granting revenue being flat year over year right around the 44 million, \$45 million number I would think with the investments historically in and insight and the schools in Latin America that we'd see some revenue growth there, is there something else going on that is skewing seasonality or is it currency, how do we think about that being flat year on year?

Joe D'Amico - Apollo Group - President, COO

Well, let me clarify. There are actually two lines there, Brandon. There's one that says non-degree seeking revenue and then there's the other royalty, other royalty is principally those other businesses and Apollo Global. Non-degree seeking revenue, we call them single courses, well, they are courses many of which are offered at the University of Phoenix that we haven't historically actively marketed. So it's just ongoing business. There is a lot of seasonality there as you see generally a tick up in Q4. So it's just not degree seeking revenue at the University of Phoenix that we actively and historically marketed.

Operator

Your next question comes from the line of Kelly Flynn from Credit Suisse. Your line is open.

Kelly Flynn - Credit Suisse - Analyst

Thanks. I have a couple of questions. First of all, just I wanted to clarify if I'm inferring from your comments correctly both Joe and Greg in talking about Q4, it seems like you are saying you're hopeful you can maintain the same start growth levels and margin expansion levels as you saw in Q3. I know you didn't give guidance but is that broadly what you think the current trends are indicating?

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

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We think that we did not say that we think they will be at the exact same levels as the third quarter but we did say we are expecting a strong fourth quarter.

Kelly Flynn - Credit Suisse - Analyst

All right. And then on the Title IV certification, I saw in the Q that WIU certification expires tomorrow. Could you let us know if that's going to go month to month or if there's been anything new there and also any color you can pride on the month to month at UOP would be helpful, too, thank.

Brian Swartz - Apollo Group - CFO

Yes, Kelly, on WIU we did submit our application I believe in March a couple of months ago on time as required so we would expect that it would go month to month similar to the University of Phoenix. There's no specific update on the University of Phoenix PPA or program participation agreement month to month but we would expect that at the appropriate time it will be renewed by the Department of Ed.

Kelly Flynn - Credit Suisse - Analyst

Finally, as it relates to the (inaudible) related to incentive comp I notice there's been a lot of activity if you will on the lawsuit, a lot of things have been filed recently. I think that's because the trial is upcoming but could you help us understand, why there's been a pick up there and then also specifically I know the plaintiff's have been seeking to extend the time frame from which they can draw evidence if you will, could you update us on that specific line if there's anything to add? Thanks.

Joe D'Amico - Apollo Group - President, COO

This is Joe, sure, Kelly. With respect to the Qui Tam, the period for which witnesses could be deposed not the experts but let's say fact witnesses came to an end or was coming to an end and the plaintiff's asked for some additional time for, to allow a few witnesses to -- who could not be deposed to be deposed. And the judge on his own extended the time frame for all of fact witnesses to a later time because he believed that there was, at least it's my understanding, that there was enough time in the schedule to actually extend the fact witness time for deposition. So that's what happened in that regard. In terms of the activity I think the activity came about because probably because we are coming to the end of the period in which fact witness depositions could be taken.

Kelly Flynn - Credit Suisse - Analyst

Okay. Then as far as the years are concerned that was actually one of the things I was referencing. I thought originally it was only allowed to cover through a certain period in '04 but the plaintiff's are trying to extend that period even to the current period. Where does that stand?

Joe D'Amico - Apollo Group - President, COO

Well, I believe -- I'm not as familiar with that point as -- it's not really directly in operations but I will give you my understanding which is that obviously we want to limit the time to back to as close to the period in which the program review took place because we believe obviously beyond that things had changed and it's no longer relevant. We obviously would like to limit the time frame that the other side would obviously like to extend the time frame. We just don't think it's relevant.

Kelly Flynn - Credit Suisse - Analyst

Okay. Thanks for taking those. I appreciate it.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

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I just want to clear one thing up on the margin I know that Andrew brought up earlier when I made the comment that we expect margin expansion I didn't mean to infer that sequentially off of this quarter. What I meant was year over year as we look to the fourth quarter we expect that. We do expect to see margin expansion again in the fourth quarter. Hopefully that was clear.

Kelly Flynn - Credit Suisse - Analyst

Thanks.

Operator

Your next question comes from the line of Trace Urdan from Signal Hill. Your line is open.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

I think that's Trace.

Trace Urdan - Signal Hill - Analyst

That's all right. I will respond to anything. So back to Mark's question I know that you are not prepared up to date the long-term guidance but I wondered if you could speak to what data points you all can see that we can't that point forward more than a quarter or two? So as you are looking at 2010 in putting your budget together can you just sort of speak qualitatively, sort of what metrics or what evidence you are able to draw from the environment that you will use to sort of put together your plan for next year?

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Sure, Trace, it's a fair question. We are working on that now as we go through our budgeting process and some of the things we rely on are how our past investments have the results that they've driven, how we think that they will continue to drive results going forward, investments that we are making in areas of academics and technology and also in a number of other areas in University of Phoenix and outside the University of Phoenix. So there's a lot of thing to put together there. And we are in the process of doing that which is why we are more comfortable giving you a flavor for what that looks like after our fourth quarter earnings. That being said you can see that from our current results that we've had some success here with some of these things already and we have confidence going into the quarter and also going forward that barring a sea change in the environment that our business is going to be pretty good.

Trace Urdan - Signal Hill - Analyst

Okay. Thanks.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Thank you.

Operator

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

Jeff Silber - BMO Capital Markets - Analyst

Thanks so much. Last quarter you disclosed I think you were told informally that there would be an annual program review and make more frequent program review. Can you give us an update on that?

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Joe D'Amico - Apollo Group - President, COO

Yes, unfortunately or fortunately there is no update but as I indicated in the last call and certain until calls after we had the conference call we actually looked at that very positively in the sense that we have nothing to hide. We are very transparent, we believe we are doing all the right things and we welcome the opportunity to demonstrate that to our regulators who we certainly feel accountable to. But first we are accountable to ourselves and the students and want to do the right thing. So having done -- and in here every year certainly limits our exposure going forward if there is any we can make corrections, just a better working relationship in my view, than waiting three or four years before you have these.

Jeff Silber - BMO Capital Markets - Analyst

Just to shift gears a bit, Greg, I think, in your remarks, you were talking about your greater focus on some of the strategic accounts of Fortune 500 companies you deal with. Can you tell us generally what the corporate tuition reimbursement environment is like right now, has it been shrinking or under pressure because of the economy?

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

We've seen, as we said last quarter our business there remains on target and we are building our business in that area. So for to us be able to tell you a lot differently this quarter, things remain on target for us. Can there be an account or two where something changes? Yes, but in general has there been a wholesale change that is showing up and driving results? No, I don't think so. Joe, I don't think if you want to add anything on that?

Joe D'Amico - Apollo Group - President, COO

No, I think that's fine. I know there are some industry's that we really don't partake in a big way that I'm sure are affected but the top companies we are dealing with still want to retain their best people in providing educational opportunities to them and paying for that is one of the benefits that they provide to their employees.

Jeff Silber - BMO Capital Markets - Analyst

Great. Switching back to the BPP transaction, have you disclosed any financial metrics around that besides what's been out there publicly and also I'm just curious how you are going to be accounting for that? Is that going to be a separate entity, are you going to be disclosing enrollments separately? Any color you can give would be great. Thanks.

Brian Swartz - Apollo Group - CFO

First of all we will be consolidated in our financial results so it will be owned by Apollo Global. Apollo Global is consolidated in our financial results so you will see it in there. We are not commenting at this point on the financial results until the deal closes so we will talk more about that after the closing. In terms of any operating metrics we might provide in that business we are still considering that and if we decide to do that we will talk more in the future.

Jeff Silber - BMO Capital Markets - Analyst

One quick follow up. Can you tell us what your CapEx budget is for the current quarter and maybe looking out to 2010 some general direction would be great. Thanks.

Brian Swartz - Apollo Group - CFO

Yes, I think on a year to date basis CapEx is in the mid \$90 million. There is nothing unusual that we would expect in the near term or Q4 or even longer term so it's kind of status quo. Any thoughts about it going forward?

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Operator

Your next question comes from the line of Andrew Fones from UBS, your line is open.

Andrew Fones - UBS - Analyst

Thanks, I guess we'll get the official cohort default numbers released before you probably next report earnings. I was wondering if you could give us any update on where you think that your cohort default rates will come in for WIU and for University of Phoenix. Thanks.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Andrew, we actually did publish the draft rates that were released I believe in April this past year for University of Phoenix it came in at 9.3% and for WIU it came in at 18.5%. Those are the draft rates from the Department of Ed. When they are finalized we will talk about it next quarter.

Andrew Fones - UBS - Analyst

Obviously we've been seeing a nice improvement in kind of retention rates, understandably I would imagine that the placement rates may be under pressure in a rising unemployment environment. Can you give us any thoughts as to how these rates may trend as we look out perhaps to next year? Do you think you can hold on to these rates? Might we see a little increase or how should we be thinking about that? Thanks.

Chas Edelstein - Apollo Group - Co-CEO

Andrew, it's Chas, I think we still have some running room in the existing programs that we have that we are working on retention. Some of the things that we talked about before, our resource centers and the training that we are doing and I think really the thing that's having that impact is we talk about retention everywhere we go. So we are building this into the culture of the organization and we get ideas bubbling up back at us from the campuses which we don't know what they will be but we still see some room there and I think we've said before there's a limit to this retention improvement because we have a high quality rigorous program. So at some point we reach a limit on that but we still see some running room with what we've got going on.

Andrew Fones - UBS - Analyst

Okay. Thank you.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Thank you, Andrew.

Operator

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

Corey Greendale - First Analysis - Analyst

Good afternoon. A couple of questions about your regulatory comments, Greg, on the 90/10, if it turns out you are above the 90% I believe the implication is you will go on provisional certification, is that right and do you expect any impact on the business that we would be able to see?

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Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Well, that's true that if we were to go over 90/10 we would get put on provisional status, as I said, we don't expect to get over 90/10 and there are various things the department can look at to regulate our business basically going forward. Could it have an impact on our business? It's possible, yes, but again we don't expect it to be over 90 and again we are managing that process aggressively.

Corey Greendale - First Analysis - Analyst

I wanted to ask about topics raised in the neg reg, the potential change in the incentive comp. I think you mentioned in public forums about things you've piloted that give you comfort that if you do need to change the way you compensate the admissions reps that it wouldn't have a material impact. Could you give a little bit more detail about that when it does give you that comfort?

Joe D'Amico - Apollo Group - President, COO

This is Joe. First of all obviously, we are complying with the regulations as we speak. That's point one. Point two is we are really focused on retention as an organization as we talked about. So I think changing comp structures if in fact that happened where retention was a larger part as a determination of comp to us is very consistent with our culture and consistent with what we are trying to achieve in terms of the student experience anyway. So I don't think it will have a big impact if there were changes but obviously we don't know what those changes are but we managed through them in the past and we will manage through it now.

Corey Greendale - First Analysis - Analyst

On another topic they raised I know it's still early days and who knows what this ends up looking like, but one of the other topics was about putting more teeth into the gainful employment and given that University of Phoenix doesn't do placement do you have any early thoughts on how that could affect you or whether you end up having to do placement or anything like that?

Joe D'Amico - Apollo Group - President, COO

Well, I think the placement really relates more to the vocational schools rather than to us. We are a degree granting university and not a vocational university so I don't think that really applies to us and that's one of the things that we've sort of have traditionally had to manage is even though we are for profit we are really, we are not a vocational school which many of the regulations are attempting to get at. I think from our perspective really the key is clarity. Tell us what the ground rules are. We know we can comply or we are pretty certain we can comply. And we've been doing this for a long time. We've had a lot of success. So just make sure -- we want to make sure we know the ground rules and we will be leaders then once we know that.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

As our founder reminds us from time to time there's been a lot of change over the past 30 or 40 years and University of Phoenix and Apollo Group has managed to comply successfully through changes, different administrations and different regulatory environments and our intent is to continue doing that going forward.

Corey Greendale - First Analysis - Analyst

Great. Thank you.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Thanks, Corey.

Operator

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

Paul Ginocchio - Deutsche Bank - Analyst

Thanks for taking my question, just a question on persistence going up. Is one of the reasons because you are being a little more selective in the leads that you pursue or the leads that you pass on to your ECs? Thanks.

Joe D'Amico - Apollo Group - President, COO

This is Joe. It's really a result of our better marketing. And qualifying the student if you will. I guess in some ways that's what it is. But we haven't, we are still open access and so we are looking at all those leads and those opportunities for students getting placed in the right program whether it's be a associate degree or bachelor degree program.

Paul Ginocchio - Deutsche Bank - Analyst

Maybe just a follow up. It sounded like last quarter you talked about managing your growth and making sure you can be consistent in your academic delivery. Is that still something we should think about that you are somewhat limiting your growth to make sure you maintain consistency?

Joe D'Amico - Apollo Group - President, COO

It is, Paul, that's -- we have said that I think more than one quarter that we believe there is value in managing this business for consistency and so we proactively would like to have more consistency in our growth?

Paul Ginocchio - Deutsche Bank - Analyst

Great. Thank you very much.

Operator

Your last question comes from the line of Scott Schneeberger from Oppenheimer.

Jim Giannakouros - Oppenheimer-Analyst

Yes, this is, this is Jim for Scott. You mentioned we should expect to see a seasonal increase in discounts due to prepayment activity but can you comment on how this year's prepayment activity compares to past years? Particularly relative to past July price increases? I guess I envisioned people would be more price sensitive in this environment. Thank you.

Greg Cappelli - Apollo Group - Co-CEO, Chairman, Apollo Global

Yes, Scott -- or rather, Jim, we don't expect any massive change from prior years for this quarter. I mean, the prepayment opportunity is there for students that have the ability to make those payments and take advantage of it.

Jim Giannakouros - Oppenheimer-Analyst

Okay. Thank you.

Operator

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Ladies and gentlemen, this concludes the Q&A session and signals the ends of today's conference call. We thank you for your participation. You may now disconnect.

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