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Grand Canyon Education, Inc. (LOPE)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello and thank you for standing by. Welcome to Grand Canyon Education, Inc. Fourth Quarter 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded.

I would now like to hand the conference over to, CFO, Dan Bachus. Sir, you may begin.

Daniel E. Bachus
Chief Financial Officer, Grand Canyon Education, Inc.

Joining me on today's call is our Chairman and CEO, Brian Mueller. Please note that many of our comments today will contain forward-looking statements that involve risks and uncertainties. Various factors could cause our actual results to be materially different from any future results expressed or implied by such statements. These factors are discussed in our SEC filings, including our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, and current reports on Form 8-K. We undertake no obligation to provide updates with regard to the forward-looking statements made during this call, and we recommend that all investors review these reports thoroughly before taking a financial position in GCE.

And with that, I'll turn the call over to Brian.

Brian E. Mueller
Chairman, President, Chief Executive Officer & Director, Grand Canyon Education, Inc.

Good afternoon and thank you for joining Grand Canyon Education's fourth quarter fiscal year 2022 conference call. GCE had a very good quarter, exceeding enrollment expectations, exceeding revenue guidance at midpoint by $2.7 million, and producing an $0.11 beat in adjusted diluted earnings per share to consensus.

Given how most of higher education is coming out of the COVID years, these are excellent results. Most importantly, GCU online new enrollment growth for the second consecutive quarter in the mid-teens over fourth quarter prior year, and that momentum is expected to continue into the first quarter of 2023.

I want to begin again by taking a step back and explaining why this is happening and briefly review what has happened since the GCE, GCU transaction took place 4.5 years ago. I have said often that in the past, small and elite has won the day in higher education, especially in areas like US News and World Report rankings. In the future, it will be institutions who are large, scalable and flexible in how they offer higher education. We expect to impact young people and adults across the lifespan, using technology to build platforms that take into account the life situation of the student and the nature of the content and skills that need to be learned.

GCE has invested approximately $300 million, producing its own learning, management and administrative system that allows it and its partners to manage over 7,000 full time and adjunct faculty, 113,000 students in over 315 academic programs, emphases and certificates across all delivery platforms. This system has automated processes, including admissions, transcripts, collection and evaluation schedule building, financial aid processing, faculty recruitment, faculty assignment and payroll, content acquisition, assessing learning outcomes, student teacher placement, counseling and social work internships, and the list goes on.

The administrative capability of the system allows faculty and students to focus on the learning, which is still in a small group instructor-led process that is highly interpersonal, collaborative, focused on writing, critical thinking, and problem solving and produces outstanding outcomes. GCE currently employs approximately 4,000 full time professionals and approximately 1,500 student workers as it continues to build out its capabilities to grow faculty, students, programs and delivery platforms for its university partners.

Leveraging this infrastructure has allowed GCE's partners to expand programs that are critical to the economy, maintain tuition levels in a period of rapid tuition increase across the country and make access to higher education affordable to all socioeconomic classes of Americans without any burden on the taxpayer.

In the 4.5 years since GCE has become a service provider, it has helped his partners accomplish the following: in that time, GCE has helped Grand Canyon University graduate 125,654 students, 34,709 in education, including 16,287 first time teachers, at a time when teacher shortages have created a national crisis; 36,292 in nursing and healthcare professions, including 1,767 pre-licensure nurses at a time when there was a huge shortage of nurses; 28,836 (sic) [23,836] in the College of Humanities and Social Sciences, including thousands in counseling and social work where there are also huge shortages.

The College of Business has become one of the largest business schools in America and has produced 21,370 graduates. The College of Science and Engineering and Technology has grown by 200% and provided 4,401 graduates. The doctoral college, Honors College and College of Theology also continue to grow. The numbers that I have just cited have all happened in the last 4.5 years since GCU has become a non-profit institution and GCE has become an education service provider.

Our partnership with GCU has given us the ability to invest $544 million additional in academic and residential life infrastructure for its ground traditional campus, bringing the total investment to almost $2 billion. Currently, the campus is ranked 17th in the country by niche.com. Very importantly, GCE has assisted GCU in opening 144 new academic programs, emphases and certificates during the last 4.5 years. 13.7% of the new students enrolled in the fourth quarter enrolled in those new programs.

During this time, GCU has not raised tuition on its ground traditional campus with only nominal increases in certain programs online. As a result, GCU students take out less debt than the average state university student. GCU students take out only 50% in parent loan amounts compared to students at our three state universities. GCU students have a 1.5% cohort default rate on student loans compared to the most recently released national average of 2.3% and has a 90/10 calculation of 66.2% per GCU's audited financials.

In addition, GCU has accumulated over $400 million in cash and investment reserves while going through with annual salary increases every year for all faculty and staff. Compared to the declining enrollments and negative financial trends in higher ed across the country that accelerated during COVID, this model has reduced significant results for GCU, the State of Arizona and the country.

I'm also pleased to announce that Grand Canyon University was ranked as the number three Best Employer in Arizona in the 2022 Forbes America's Best Employers By State Report. During this time period, GCU has established 26 additional university partnerships. These partnerships, along with our partnership with GCU, have created 35 locations to produce health care professionals, especially baccalaureate-prepared nurses. This is extremely important work since the country is expected to need 1.3 million additional nurses in the next five years alone. A number of existing and new partners will eventually lead to 80 locations across the country.

Since January 2019, 9,182 students have graduated from our university partners' ABSN or OTA programs. I want to include this brief summary because there is currently a lot of discussion about the future of higher education. Regardless of political or ideological positions, the discussion should focus on where the economy is going and where the new jobs and careers are going to be. Models that can scale and offer opportunities for access to all socioeconomic classes of Americans at no expense to the taxpayer, should be supported.

Critics point to the revenue share model as bad for universities. The past two years have proven them wrong, and we expect in the next year this will become even more apparent. In inflationary periods like the one we are currently experiencing or when demand declines as it has, GCE as a service provider absorbs the majority of the financial risk and our expertise, technology and processes have allowed our university partners to continue to benefit during these challenging times.

Now, I want to review the four pillars or delivery platforms of Grand Canyon Education. First, GCU's traditional campus saw an increase of 8.9% in new students in the fall of 2022 over prior year, an increase of 8% in total grounds traditional enrollment and an increase of 10.5% in residential enrollment. Approximately 69.9% of ground traditional students live on campus. The average incoming GPAs of the 2022-2023 class rose to 3.6 and the prestigious Honors College has grown 8.3% year-over-year, with average incoming GPAs of 4.1.

The retention of returning students this fall was better than expected, with a larger percentage of those students choosing to remain on campus, resulting in the university having to turn away at least 200 new students due to lack of beds. This, in spite of the fact that the university built two new residence halls and repurposed a residence hall that was used to house prospective students, so in essence added three residence halls.

These are remarkable results given the fact that undergraduate enrollment declined by 4.2% nationally between the fall of 2020 and fall of 2022 or during this same period, GCU's ground traditional enrollment increased by 18.3%. In a spring semester that recently started in January, GCU started 670 new students, bringing a total ground enrollment to approximately 22,500, above what was budgeted. We expect fall new enrollments to be between 10,000 and 11,000.

The quality and relevancy of GCU's academic programs, the low-class sizes in support of its faculty that has less than a 5% turnover rate, the quality of counseling service of the 20 advisory boards with over 500 companies represented, who are creating internships and employment opportunities for GCU students in a very affordable tuition which hasn't been raised in 15 years, are all important contributing factors.

I also want to mention, unlike the national trend, over 2,600 of the 9,300 fall 2022 new students this year were first-gen college students. The average incoming GPAs of these first-gen students is 3.55 or almost identical to the incoming class overall. These students are largely from the lower socioeconomic strata, but their enrollment at the university, because of the very affordable tuition rate, is going directly against the national trend and is a very positive part of the GCU/GCE story. As I said before, in the fall of 2023, we are anticipating between 10,000 and 11,000 new students.

We are under construction on two new residence halls that will increase the number of beds on campus by 1,500. The number of new students will ultimately depend on the retention of continuing students and their desire to remain on campus and the very competitive environment given the trends we have discussed previously. Less high school graduates, less graduates going directly to college.

Pillar two. Working adult students attending GCU online. As with traditional students attending universities across the country, 2021 saw a downturn in working adult students attending online. Unlike with the traditional students attending GCU's campus, we experienced a downturn in online as well. GCE has worked with GCU on two main strategies to combat the downturn, and we are now seeing positive growth again.

Number one, we have invested in B2B strategies that are well-timed with this post-COVID period. The supply and demand, at least in the short run, for educated labor has flipped. Since the country has reopened, we are working with over 25,700 industry partners in K-12 education, health care, financial services, social service agencies, technology and engineering companies, military bases, et cetera, developing custom strategic initiatives that are helping organizations grow their talent from inside. The number of new students that started through these strategies grew 27% over the prior year in the fourth quarter.

Number two, GCE continues to work with GCU to roll out new and relevant programs. Since the transition 4.5 years ago, GCU has rolled out 144 new programs, emphases and certificates. 13.7% of new students enrolled in these programs in this latest quarter. This has resulted in fourth quarter new online enrollments growing in the mid-teens over the prior year, and we are currently projecting new enrollment growth in the first quarter of 2023 to be similar, high-single-digit to low-teens.

Based on these trends, we will return to total online growth this quarter, which is quicker than we thought. It is important to note that this return to positive growth has been accomplished with no loss of strength in the quality of GCU's online student body, and as a result, no degradation of the quality metrics including good graduation rates, low cohort default rates and continued low student debt levels.

We anticipate new enrollment growth to again be in the high-single digits, low-teens in the second quarter, and then we'll begin to return to our long-term objective of mid-single-digit growth in the back half of the year as the comps get much tougher. This should allow us to grow total enrollment on a year-over-year basis in the low- to mid-single digits by the end of the year.

Next I would like to discuss GCE's third pillar is health care partnerships. Short-term COVID had a negative impact. Hospitals were extremely busy and preoccupied with COVID patients and many clinical placement opportunities were cancelled. Despite these very significant challenges, many instructional assignments requiring one-on-one clinical interaction in the hospital were replaced by simulations.

Some of our university partners requested that we reduce the cohort sizes due to concerns about the lack of clinical capacity, and some of the new sites that we hoped to open, especially in large markets, have been pushed back to the fall 2023 or 2024. Although positive signs are emerging on this front, the tight labor market has had a significant impact on the type of student interested in re-careering into nursing.

When we acquired Orbis Education in 2019, their partnerships were predominantly focused on post-baccalaureate students, those that had already completed a bachelor's program. And having a completed bachelor's degree was a requirement to start in the ABSN program. Students that did not have a bachelor's degree were turned away. Today, the majority of the students interested in re-careering into nursing have not completed a bachelor's degree. Thus, we have been working with our partners and their state nursing boards to adjust these programs to allow students with 60-plus college credits to gain admittance into the ABSN program.

In addition, as I will discuss in more detail below, in partnership with GCU, we have created a much less expensive and more efficient way for these students or students that do have a bachelor's degree but don't have the science prerequisites to complete the coursework necessary to start in the ABSN program.

These challenges have, in the short run, caused some of our mature locations that were at capacity to shrink in some of our newer locations to not grow as fast as we would have expected while other mature locations remain at or near capacity and some newer locations are meeting our new enrollment expectations.

We are hopeful that these strategies will re-accelerate growth beginning in the fall of 2023. As we work through this, we will be much more selective in the new locations that we open. We plan to open a new site with a new partner in Southern California and two new sites with GCU in the Phoenix area in the fall of 2023.

We also plan to open a couple of smaller sites with new partners that we're committed to previously. I am very pleased to announce that GCU locations grew 19% year-over-year from 269 students to 320, and that their first 71 graduates passed the NCLEX examination with 100% first time pass rate. This is extremely important because GCU would ultimately like 40 of our 80 sites to be GCU locations. This relationship is good financially for GCU but is also good for GCE, given GCU's national footprint and brand recognition, the excellence of its nursing program and its proven ability to scale.

As with GCU's traditional campus, the long-term environment is very positive for these GCE health care partnerships for the following reasons. Number one, the country needs 1.3 million additional nurses in the next five years alone. Nursing programs are very expensive to operate, and given the financial pressures facing many universities, they will be unable to invest the dollars it will take to scale the programs.

Number two, GCE has the capital to invest in the continued build out to eventually 80 locations. Number three, in addition to the runway of 80 locations, up from 35 locations currently, our enrollment budget for this coming year is only 50% of the actual spots that exist today. The 50% shortfall is partly due to the lack of efficient and highly supportive prerequisite course environments, regulatory issues creating slowdowns in opening of planned locations and a lack of clinical placements due to COVID issues.

However, there are now over 800 students in GCU's accelerated online science courses preparing to earn spots in one of our 35 locations. We expect that number to grow and be a leading indicator of our ability to re-establish growth on the hybrid campuses.

GCU is working hard in investing in new enrollment, simulation, virtual reality and prerequisite strategies to in the future fill all the spots that are available. This is a transitional year for the health care partnerships. However, there's a 10-year runway that is very promising. It creates a winning scenario for students that want into a promising career, health care providers desperately needing professional nurses and universities who want a low risk way to help solve the nursing shortage while at the same time creating additional revenue streams.

Last, as we discussed on last quarter's call, we continue to work on a new pillar. We are extremely excited because it is desperately needed in higher ed today. In collaboration with our largest partner GCU, we are developing accelerated certificate programs. Two of the certificate programs are for students who want an efficient way to get into nursing school. We believe there's a big opportunity here. Getting prepared academically to apply to nursing school can be a daunting and confusing process. The first, a pre-nursing certificate program allows recent high school graduates to stay home and take the first 60 credits of their bachelor's degree completely online.

GCU has worked with GCE to design state-of-the-art science courses that prepare students to apply for a spot in eventually one of our GCE's 80 locations. These courses are taught mainly by full time faculty with a tremendous amount of academic support for the students. The second certificate program is designed for students who have completed a college degree in another academic area or have a partially completed degree. The students take mainly the science courses necessary to produce to apply to one of our partners in one of our 80 locations.

The first certificate has a synchronous component, while the second certificate is being taught completely asynchronously. Given that eventually GCE will have approximately 24,000 ABSN slots to our partners across 80 locations, we will need more than 24,000 students in certificate programs preparing for those opportunities. As I said earlier, over 800 students are taking these pre-nursing courses currently.

The third certificate program began in September and comes out of GCU's newly formed Institute of Workforce Development. This certificate is preparing students for a professional electricians apprenticeship program. This is a 16-credit, one-semester program, heavily focused on the mathematical concepts necessary to prepare for a career as an electrician. This program has been designed with a major industry partner who will offer apprenticeships to the students successfully completing the program.

This partner needs 1,000 electricians for their business in Arizona alone. This partner also indicates that the country is short of minimum 100,000 electricians necessary to complete the building projects currently under way. This fall, 300 students applied for this program and we accepted 40 into the program. 39 of the 40 graduated and are in apprenticeships, making between $50,000 and $65,000 currently. An additional 200 submitted applications for the spring semester and we accepted another 40 in the spring. Once the concept is proven, there is a potential to scale this program in a significant way.

Service revenue was $258.7 million for the fourth quarter of 2022, an increase of $7.3 million or 2.9% as compared to the $251.4 million for the fourth quarter of 2021. The increase year-over-year in service revenue was primarily due to an increase in GCU's traditional campus enrollments of 8% and increases in revenue per student year-over-year, partially offset by a decrease in online enrollments at GCU of 1.6% and to a lesser extent students in our university partners' Occupational Therapy Assistance program of 11.3%.

Operating income for the three months ended December 31, 2022 was $90.7 million, a decrease of $11.7 million, as compared to the $102.4 million for the same period in 2021. The operating margin for the three months ended December 31, 2022 was 35.1% compared to the 40.7% for the same period in 2021. The operating margin was negatively impacted by the investments that are being made to grow our partners' enrollments and the year-over-year decline in online enrollments.

Net income decreased 16.5% to $71 million for the fourth quarter of 2022, compared to $85.1 million for the same period in 2021. Decline in net income was partially due to a significant reduction in interest income between the years due to GCU paying off the secured note in the fourth quarter of 2021. GAAP diluted income per share for the three months ended December 31, 2022 is $2.30. As adjusted, non-GAAP diluted income per share for the three months ended December 31, 2022 is $2.36, $0.11 over consensus' estimates.

With that, I would like to turn it over to Dan Bacchus, our CFO, to give a little more color on our 2022 fourth quarter, talk about changes in income statement, balance sheet and other items, as well as to discuss the updated 2022 guidance.

Daniel E. Bachus

Chief Financial Officer, Grand Canyon Education, Inc.

Thanks, Brian. Included in our Form 8-K filed with the SEC, we have included non-GAAP net income and non-GAAP diluted income per share for the three months ended December 31, 2022 and 2021. The non-GAAP amounts exclude the tax-effected amount of the amortization of intangible assets of $2.1 million in the fourth quarters of both 2022 and 2021.

The tax-effected amount of the loss on fixed asset disposals of $0.1 million for the three months ended December 31, 2022, and both the tax-effected amount of the reversal of the $5 million credit loss and the tax-effected amount of the write-off of the deferred loan costs of $1.1 million upon repayment of the credit facility recorded during the fourth quarter of 2021. We believe the non-GAAP financial information allows investors to develop a more meaningful understanding of the company's performance over time.

As adjusted non-GAAP diluted income per share, as Brian just mentioned, for the three months ended December 31, 2022 and 2021 is $2.36 and $2.11, respectively. Service revenue was higher than our expectations in the fourth quarter of 2022, as online enrollments exceeded our projections due to the higher than expected new student starts and due to higher than expected ancillary revenues at GCU.

Hybrid revenues were in-line with our expectations. The hybrid enrollment growth rate is being impacted on a year-over-year basis due to the timing of site openings, an 11.3% year-over-year decline in OTA enrollments, the closing of sites, and a decline year-over-year in their enrollment at some of the mature sites due to the challenges previously discussed.

Excluding enrollments from closed sites, ABSN enrollments grew 3.6% year-over-year. Revenue per student continues to grow on a year-over-year basis, primarily due to the service revenue impact of the growth in the GCU traditional campus enrollments between years, which has a higher revenue per student due to room, board and other ancillary revenues, and the higher revenue per student at off-campus classroom and laboratory sites.

Service revenue per student for hybrid ABSN students generates a significantly higher revenue per student than we earned on the other students, as these agreements generally provide us with a higher revenue share percentage, the partners have higher tuition rates and the majority of their students take more credits on average per semester as they are in accelerated programs.

Our operating margin was higher than our expectations primarily due to higher than expected revenue. As I discussed on prior quarters' earnings calls, we have been aggressively hiring in which head count had mostly been flat since March of 2020 to meet our partners' expected future growth which is driving increased compensation costs in technology and academic services and counseling services and support cost.

At the end of the third quarter 2022, we remained below our head count plan, but are at head count plan today. We also planned for a significant increase year-over-year in travel and employee benefits as those amounts were significantly lower than pre-COVID levels in the prior year. We also planned for increased clinical costs at off-campus classroom and laboratory sites due to the nursing shortage. This spending has generally remained in-line with our expectations and the year-over-year difference in the timing of new site openings impacts year-over-year cost comparisons.

Our effective tax rate for the fourth quarter of 2022 was 22.8%, compared to 21.8% in the fourth quarter of 2021 and our guidance of 23.0%. The increase year-over-year is due to higher state income taxes. We repurchased 318,935 shares of our common stock in the fourth quarter of 2022 at a cost of approximately $28 million, and another 154,098 shares since December 31, 2022.

We have $178.4 million remaining available as of today under our share repurchase authorization. The board of the company intends to continue using a significant portion of its free cash flows from operations to repurchase its shares, but share repurchases in future years will be less than in 2021 and 2022 as we have utilized all of the proceeds from the repayment of secured notes during the past two years.

Turning to the balance sheet and cash flows, total unrestricted cash and short-term investment investments on December 31, 2022 were $181.7 million. GCE CapEx in the fourth quarter of 2022, including CapEx for new offsite classroom, campus classroom and laboratory sites were up was approximately $8.9 million or 3.5% of service revenue with total CapEx for 2022 of 35 million. We expect CapEx for 2023 to be similar to 2022 at between $30 million and $35 million.

Last, I'd like to provide color on the updated guidance we have provided in our 8-K filed today. As a reminder, the guidance that we have provided in the outlook section of our 8-K filed today is GAAP net income and diluted income per share with components to adjust the GAAP amounts to non-GAAP as adjusted net income and non-GAAP as adjusted diluted income per share. And we will continue to provide both GAAP net income and diluted income per share and the non-GAAP amounts with a reconciliation between the two when we report actual results.

Consistent with the prior year, we have provided ranges for revenue, operating margin and earnings per share for each of the four quarters of 2023. We do this because our financial results are seasonal. Revenue range assumes the following. GCU ground enrollment will grow to 23,200 in the spring, 7,800 in the summer, and be between 26,250 and 27,750 in the fall. The ground number continues to include GCU hybrid and professional study students. Residential students are projected to grow to 15,700 in the spring and between 17,900 and 18,900 in the fall.

Timing differences in the start and end of the traditional campus semester is pushing 4.5 million from Q1 2023 to Q2 2023 in comparison to 2022, and 1.3 million from Q4 2023 to Q3 2023 in comparison to 2022. We anticipate that new online enrollments will be up year-over-year in the high-single digits to low-teens in the first and second quarters.

As a reminder, the comps get much more difficult in the second half as new enrollments were up year-over-year in the mid-teens in both the third and fourth quarters of 2022. Thus, our guidance provides a wide range of potential outcomes in the second half of between low- and high-single-digit growth. Given that our long-term objectives are to grow new enrollments in the mid-single digits, the midpoint of this range would meet our long-term objective.

Based on this, we anticipate that total online enrollment will return to year-over-year growth in the first quarter of 2023 and we'll end the year with a low- to mid-single-digit year-over-year growth rate. As Brian discussed earlier, hybrid growth will remain below our long-term objectives during the first half of 2023, but we are hopeful that we will see acceleration beginning in the fall semester due to new site openings and the impact of the prerequisite initiative on the number of eligible students that can start in our partners programs.

Our guidance assumes flat to slightly down year-over-year total enrollment in the spring semester, flat to low-single-digit enrollment growth in the summer, and flat to mid-single-digit growth in the fall semester.

On the expense side, as you recall, we made significant investments in 2022 for expected future growth, which, given the timing, this would impact our margins in the first half of 2023. Headcount which is mostly flat since March of 2020, was increased over the course of 2022, with the most significant gains being made in the fourth quarter of 2022 and early 2023. This will drive year-over-year increases in compensation costs and technology and academic services, and counseling services and support costs in the first nine months of the year, but that growth will slow in the fourth quarter.

We're also continuing to budget for increased clinical sites at offsite locations – good clinical costs at offsite locations due to the nursing shortage, and new site openings will have a negative impact on expense. We do anticipate that the hybrid pillar will continue to lose money in 2023 given that a number of mature sites are currently below pre-COVID counts. To get back to profitability, these sites need to get back to pre-COVID enrollment levels and the newer sites need to grow at rates more similar to what we experienced pre-COVID. We are hopeful the initiatives that Brian discussed earlier in the call will allow that to happen even if the job market remains tight.

We do not plan to have any material interest income or expense. We believe the effective tax rate for the four quarters of 2023 will be 22.3%, 24.9%, 24.9% and 24.0%. The effective tax rate will be higher in 2023 than in 2022 because of the impact of state taxes as revenues continue to grow at the offsite locations outside of Arizona driving our tax rate increases. These estimates do not assume the contribution in lieu of state income taxes. If one is made, that will increase G&A expense in the third quarter and decrease the effective tax rate in the second half of the year.

Our weighted average shares guidance assumes that we purchased most of the remaining amount authorized by our board evenly over the rest of the year. The board continues to authorize the repurchase of shares as it believes the stock remains undervalued based on the metrics it uses to evaluate, including the ratio of enterprise value to adjusted EBITDA and the free cash flow yield rather than multiples of other education companies.

As although we can be viewed as being in that same sector, there are few, if any, appropriate comps. On an enterprise value to adjusted EBITDA basis, the stock is currently trading at roughly 12.2, which is less than the recent S&P average of 16.4, the average free cash flow yield for the S&P 500 of 2.8%, whereas the company's free cash flow yield is approximately 5.5%.

Last, the guidance provided does not include any reduction in revenue or expenses associated with a Dear Colleague Letter issued last year that I discussed last quarter. As a reminder, the Dear Colleague Letter does not impact our relationship with GCU as GCU provides all faculty for their courses, pays them, and receives little to no reimbursement from us or any other outside sources for the faculty costs.

But we are still working with our other university partners to assess the impact of the Dear Colleague Letter, if any, on the programs we partner with them on. We will provide updates to our outlook if contractual changes are needed but is important to note that any changes made would have an immaterial impact on revenue and operating profit.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from the line of Jeff Meuler with Baird. Your line is open.

Jeffrey P. Meuler
Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Thank you. How is demand trending lately for the hybrid programs? And you gave us the number on the 800 students. I don't know if this is too soon, but can you give us any sort of metrics on the success those students are seeing going through the accelerated online pre-reqs?

Brian E. Mueller
Chairman, President, Chief Executive Officer & Director, Grand Canyon Education, Inc.

A

Yeah. The demand is changing because of the employment situation. The employment situation is so strong. There are so many jobs out there that people with bachelor's degrees in their 20s are not really willing to give up a $60,000 a year job to invest $50,000 or $60,000 to make $70,000 or $80,000. The same return if they're currently in. So people are being more cautious about re-careering. However, the demand is still very strong and increasing for those students that are younger and haven't already invested in higher ed and don't have any debt or have very little debt.

And so, there is significant demand. What's very interesting and very encouraging is that, when we can get students to the ABSN start – get them to the front door, we have a 90% success rate getting them through and a greater than 90% first time pass rate on the NCLEX exam. The challenge is getting them so that they have the coursework necessary to get into the ABSN program.

People were referring them to community colleges and they wouldn't hear from them for a year or two or three if at all. And in other places, the programs were not delivered online or they were extremely expensive. And so, we worked very hard at creating first the science courses. And those science courses, that's what I was referring to in terms of the 800 students and growing pretty rapidly. And we have between 75% and 80% success rate, meaning the students got a C or better in those courses. And therefore, they can use them to get into an ABSN program.

So, we're really happy with that success rate because studying science online is not easy, our courses are rigorous. But the demand is still very strong and we think we're going to be in a very strong position somewhere between 6 and 12 months, because I think we've figured out, it doesn't matter where in the country a student is. Our programs are delivered online. So, they can be entered into the program. We've got start times every couple of weeks. And as opposed to, once a fall or just spring semester and what time was being offered in person, all those things were really difficult to navigate.

And so, I think the most important challenge is that one. And between that and we think we'll get some traction with high school graduates who want to stay home through the first two years of pre-nursing program in 18 months, do it completely online, and then qualify to be in an ABSN program in one of our locations throughout the country. Between those two things, we're hoping to address that challenge, and then re-accelerate the enrollments.

Jeffrey P. Meuler
Analyst, Robert W. Baird & Co., Inc.

Q

Got it. And then, GCU looks like it's tough to get back to growth. On margins, I understand the annualization effect of the head count ramp. I understand the trade-off to the benefit of the university of the current financial model in a lower demand and higher inflation environment. But to the extent to which the university may be getting back to enrollment on a sustained basis and since you're caught up on head count, just any comment on what you'd expect on a multi-year basis in terms of margins, while still probably balancing not taking tuition pricing increases?

Daniel E. Bachus
Chief Financial Officer, Grand Canyon Education, Inc.

A

Yeah. We believe that once we can get back to mid-teen total enrollment growth online, that that core GCU contract margins can expand on an annual basis year-over-year somewhere between 30 and 100 basis points, where we were pre-COVID. And we believe that because, one, we've done it in the past; two, mid-teens online enrollment and the growth of the ground campus and the revenue per student from that can help drive that margin expansion.

And when you look at – if you look at the high end of our guidance which is, if everything goes perfectly as we hope this year, you will see margin expansion – you do see margin expansion on the GCU core in the second half of the year. If we hit the midpoint of our guidance we gave today from a revenue standpoint, it would be fairly flat the second half of the year on the GCU contract from a margin standpoint. So that gives us confidence we can do it.

Brian E. Mueller
Chairman, President, Chief Executive Officer & Director, Grand Canyon Education, Inc.

A

The other thing that impacts that, because you've followed this thing historically, we've gotten margin gains by cost to acquire a student going down. And when we mentioned in the fourth quarter that 27% of our new enrollments are 20% – we were 20%, 7% higher this fourth quarter than prior year's fourth quarter in new enrollments that were coming from our outside people. And those were basically working with school districts and others and we don't pay for those leads. And so we're hoping that that number continues to grow because that is where historically we've gotten margin expansion is by reducing the cost to acquire a student. And if that work continues to go as it does, that will help.

Jeffrey P. Meuler
Analyst, Robert W. Baird & Co., Inc.

Q

Got it. And I may not have heard correctly. I think you said mid-teens. You mean mid-single-digit growth for online growth?

Brian E. Mueller
Chairman, President, Chief Executive Officer & Director, Grand Canyon Education, Inc.

A

Yes. Dan is sitting next to me and he punched me on that. So, yes, mid...

Jeffrey P. Meuler
Analyst, Robert W. Baird & Co., Inc.

Q

I'll take [indiscernible] (41:38).

Brian E. Mueller
Chairman, President, Chief Executive Officer & Director, Grand Canyon Education, Inc.

A

Yes, you are correct.

Jeffrey P. Meuler
Analyst, Robert W. Baird & Co., Inc.

Q

And then just last, I know you talked about the former Dear Colleague Letter. There was another Dear Colleague Letter last night regarding third-party services in Title IV. When you lift up the services, Brian, you talk about financial aid processing being one of them. So is the GCE/GCU contract, are you already, I guess, subject to these types of regulations and oversight, so no impact on you? And then just on the hybrid contract, is it a different setup? And just if there is any sort of like qualification of how burdensome that may or may not be for you?

Brian E. Mueller
Chairman, President, Chief Executive Officer & Director, Grand Canyon Education, Inc.

A

Yeah, you're right about the financial. GCE provides that service for GCU, which is the bulk currently of the business. And so, yes, we're already subject – GCU is subject to an audit as a result of doing that financial aid work and GCE does really, really well in that audit process. So we feel very good about that.

The other 26 partners...

Daniel E. Bachus
Chief Financial Officer, Grand Canyon Education, Inc.

A

Yeah, I think a couple of points to expand on what Brian just said. I mean, I think it's important for people to know that as part of the audit that Brian talked about, they not only look at the financial processing and compliance but they do payroll testing, including an in-depth review of incentive compensation plans and payments, fiscal testing, including program reconciliation, bank statements, contract, and contract testing including division of services and responsibilities.

So as it relates to GCU, I think we are already a third-party servicer and go through a full audit similar to what I think the Department of Ed is pushing for on the Dear Colleague. As it relates, as Brian said, to the other 26 partners, they don't do that audit currently for those. But for us to add that testing for our other 26 partners would not be a problem at all. The compensation plan is very similar and the other controls and processes are very similar for us. Not a concern at all to have that expanded to our other 26 partners.

Jeffrey P. Meuler
Analyst, Robert W. Baird & Co., Inc.

Q

Okay. That's it for me. Great to see GCU doing so well. Thanks, guys.

Brian E. Mueller
Chairman, President, Chief Executive Officer & Director, Grand Canyon Education, Inc.

A

Thanks. Thanks.

Daniel E. Bachus

Chief Financial Officer, Grand Canyon Education, Inc.

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

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.