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Grand Canyon Education, Inc. (LOPE)

Q4 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Fourth Quarter 2020 Grand Canyon Education, Inc. 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] As a reminder, today's program is being recorded.

And now, I'd like to introduce your host for today's program, Mr. Dan Bachus, Chief Financial Officer. Please go ahead, sir.

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, Grand Canyon Education, Inc.

Good afternoon and welcome to Grand Canyon Education's fourth quarter conference call. GCE continues to gain real momentum as an educational services provider. We are building three unique and differentiated platforms that will provide significant growth for GCE and make a major impact on this country in the next 10 years. In 2021, GCE will assist its partners in producing over 35,000 new graduates at either the bachelor's, master's or doctoral level.

The pandemic has been a serious challenge for universities and many are experiencing financial problems. In addition, recent college graduates who are new to the job market are having a difficult time. Many have degrees that aren't serving them well in the current economy. It has been GCE's goal to create educational models that address the real issues within higher education. I believe these issues are the following.

One, the out-of-control rising cost of university education. From the early 1980s to the late 2010s, the price of college increased eight times the increase in wages. Number two, the increasing student debt levels that will seriously hinder graduates as they begin their adult lives. Three, as tuition levels go up at universities, diversity on college campuses go down – goes down. Four, bachelor's degrees should not take four to six years to complete. Five, programs and delivery models lack the creativity and the flexibility necessary to address critical shortages in some industries.

Six, there are inadequate counseling and support services, especially for first-generation students or those studying at a distance. Seven, three-fifths of college graduates would change their majors if they were starting over. Eight, prior to the pandemic, 43% of college graduates were underemployed in their first job. Two-thirds remained in jobs that don't require college degrees five years later. Nine, most professors have no formal training in teaching, learning or course design.

Grand Canyon Education is a large organization, over 4,600 staff, is in a very strong financial position and can invest in educational infrastructure to help institutions address some significant challenges and opportunities in the employment marketplace. One of our partner institutions now derives 13% of their total revenues from GCE/Orbis healthcare programs and they want to do more. The combination of institutions looking for additional revenue streams and our ability to help them launch programs locally that prepare students for in-demand occupations is creating rapid partnership growth and a very bright future for GCE.

Let me explain how GCE is in a great position to support the three main pillars or platforms of our business. The first pillar, Grand Canyon University Online, has 89,439 students as of December 31, 2020, and in the quarter just completed, new students grew on a comparable start basis in the high single-digits, while total students grew 8.3% year-over-year. The total number of GCU Online students continues to exceed our expectations, driven by very strong start growth and continued strong retention rates. We continue to see strong interest in GCU Online programs and the number of students that are attending at the graduate level continues to go up, which is why retention and graduation rates are so high.

GCE continues to work with GCU to ensure that student growth takes place at levels and in programs that will produce high-quality outcomes. The university's cohort default rate is 5.8%, which is well below the national average which is almost 10%. However, this is the pillar of our business that is the most competitive. I have spoken previously about our strength in new program development. Understanding where the economy is going, where the jobs are going to be and creating programs that help students get those jobs is a differentiating factor for us. Most OPMs can't create new academic programs at near the rate that GCE/GCU can build them.

A second differentiating factor is offering programs that lead to professional licensure. Programs in education, counseling, healthcare, et cetera, that lead to licensure tend to have more clearly defined career paths and higher retention and graduation rates. Those programs are far more difficult to offer because it's difficult to manage at scale and at a distance the many details and requirements that are often state-specific. Most OPMs aren't equipped to assist their partner institutions on the operational details of those programs, which are very important to students.

GCE has invested heavily in personnel, technology and automation that allows GCU to offer those programs and to ensure that students meet all state-specific requirements. Of GCU's 89,400 online students, approximately 38,000 are in those programs. The second pillar or platform to our business is the GCU traditional campus. As many of you know, GCU shifted its start date for the Fall semester for its ground students from August 24, 2020, to September 8, 2020, which resulted in five more revenue-producing days in 2020 as compared to the fourth quarter in 2019.

Approximately 4,900 of GCU's traditional campus students elected to attend the Fall semester entirely in the online modality, resulting in approximately 11,500 residential students compared to bed capacity of approximately 14,500. Although this resulted in less room and board revenue in the Fall semester at GCU, and thus impacted our service revenue, the number of students electing to take all of their classes online had the effect of increasing total capacity, allowing the university to exceed its enrollment expectation by roughly 600 students to a total of 22,185. This is in stark contrast to what many universities in the country are experiencing.

Ground enrollments in the Spring 2021 semester are also strong. The university had its largest Spring new start cohort and a better-than-expected retention rate resulting in Spring enrollment of approximately 20,250, which includes an increase of 11.4% in ground traditional students. The university typically sees a significant decline in residential students between the Fall and Spring semesters due primarily to graduations. But a large number of students returned to campus in the Spring, increasing the residential enrollment to approximately 11,600.

3,500 students did not choose to attend the Spring semester entirely – did choose to attend the Spring semester entirely in the online modality, which is higher than we had predicted at the time of the last conference call. This was primarily due to the spike in COVID-19 cases in the Phoenix area around Christmas. Currently, on GCU's campus, there are fewer than 30 active positive COVID cases. The university recently put a message out stating that the campus intends to be fully up and running in the traditional manner in the Fall semester of the 2021-2022 academic year.

GCU's traditional campus is in a very strong position and is becoming a bigger part of the strategy every day. GCU's goal is now to have 40,000 students on its traditional campus in West Phoenix. The pandemic has made it abundantly clear that 18-year-old students desire to have a campus experience as much now as they ever have. It just needs to be affordable. The combination of GCU and GCE in building out the traditional campus has many strategic advantages.

One, Phoenix is a destination city. Arizona is a destination state. Two, GCU has invested $1.5 billion in educational infrastructure and the campus is currently ranked 19th in the country. Number three, GCU hasn't raised tuition in 12 years and their students take out less debt than the average state university student. In addition, The Wall Street Journal recently released average Parent PLUS debt amounts. GCU parents take out approximately 50% of the debt amount taken out by the three heavily subsidized state universities in Arizona. Four, GCU now has nine colleges that have over 200 (sic) [280] academic programs, emphases and certificates.

Five, GCE is adding more than 20 new programs per year targeted at growing occupational areas. Six, the university will invest $500 million additional dollars in the next four years with the plan to grow out its campus to accommodate 40,000 students. The university is in a strong financial position in the aftermath of its split from

GCE to become a non-profit institution. It is financing all its current CapEx and has $317 million in cash as of December 31, 2020. In addition, during the pandemic, GCU/GCE has had no layoffs, has gone through the annual increase in salaries for its faculty and staff, and has hired 461 new employees. Those that predicted the transaction would produce financial ruin to the university were very, very wrong.

Seven, GCE has almost 200 people involved in the recruiting process. Eight, GCE has a state-of-the-art marketing and advertising agency to develop efficient and productive campaigns. Nine, GCE has invested heavily in building out virtual tours of campus and live lab, classroom demos to expose current high school students to GCU during the pandemic when travel is limited. 10, GCU's Christian and free market positioning makes it attractive to a large national audience with very few affordable scalable options.

The third pillar or platform of the business is Grand Canyon Education/Orbis. Going forward, we are combining how we talk about what we used to refer to as the third and fourth pillars in order to simplify and better explain our strategy. Our goal is to continue the rapid expansion of partners, some of which want to provide both healthcare and non-healthcare programs. GCE bought Orbis 23 months ago. Since that time, we have expanded to 25 partners and 30 locations. The goal is to have over 40 locations by the end of 2022, 50 locations by the end of 2023 and eventually to grow to 80 locations. This is a huge national platform in which to enroll students and to produce graduates.

GCE now not only has the largest partner in the OPM space, GCU, it's also rapidly adding partners. This is happening because first, many quality universities are experiencing financial stress and looking for options to increase their revenues; second, there are important healthcare and other technology careers that are experiencing serious shortages; third, universities don't have the resources to scale many of those programs; fourth, GCE has the capital and the knowhow to scale those programs and create opportunities for thousands of underemployed young adults, while helping universities create important additional revenue streams.

Most locations start with the ABSN program, but most have the ability and desire to scale up to as many as 10 additional programs. Sites will eventually accommodate between 250 to 1,000 students in multiple programs. Programs will cost between $30,000 and $60,000, take between 12 and 24 months to complete, and lead to jobs paying between $50,000 and $100,000. Most of the students in those programs will have already completed a bachelor's degree, but consider themselves underemployed. GCU will fill many of the sites in the West and will continue to expand into additional healthcare and non-healthcare academic areas.

We continue to have conversations with Valparaiso. But due to recent changes in administration, the completion of the contracts have been delayed. We are excited to have signed an MOU similar to the one with Valparaiso with another university and have reached verbal agreement on the structure of the healthcare and non-healthcare components, which include a revenue-share arrangement for the healthcare component consistent with our other healthcare partners and a cost-plus component to provide services for some of their graduate online programs.

Grand Canyon Education has three large, well-financed, highly professional platforms to grow with in the next five years. Each platform is addressing real needs in the market and is producing high quality outcomes for our partners and the economy. I have never been more excited about the future of GCE. I want to speak just for a moment on corporate and university social responsibility. For a full description of our efforts, please refer to the 10-K that was just put out prior to this conference call. I want to talk briefly about one part of these efforts.

Our primary purpose at GCE is to work with our university partners to develop human capital, to serve the economy and the culture we live in, and to maximize human flourishing. We spend most of our time describing those efforts. We also however want to have a direct impact as organizations on the challenge of poverty in the neighborhood that GCU and GCE lives in. This is an area comprised of many immigrant populations. There are over 40 languages spoken within 5 square miles of GCU and GCE. In the last eight years, we have had many university administrators visit the GCU campus to learn about its efforts in an attempt to replicate them in some fashion.

We put in place what we call a 5-point plan eight years ago. The goal was to transform an inner-city neighborhood into a thriving middle-class community. The first point was to grow the university and GCE in this community, creating jobs and providing an economic catalyst. Together, GCU and GCE now have 14,000 jobs between full-time and adjunct faculty, staff and student workers, and we are hiring many in the neighborhood into entry-level positions where they get a salary, benefits and their children can go to college for free if they make the admissions requirements.

This can change the long-term trajectory of a family living in poverty. Second point is to spin as many new businesses off of this one as possible. GCE and GCU have started 10 new businesses that employ now over 500 people, many of whom live in this immediate neighborhood. Those jobs also provide families with a salary and benefits and the opportunity for their children to attend college.

Third – the third point is safety. The students were having trouble getting to school – K-12 students were having trouble getting to school and back home, and their parents were having trouble getting to work safely. Together, we continue to invest in a major partnership with the City of Phoenix Police to eliminate gang activity, prostitution and drug dealing. Over $2 million have been invested in this initiative. It has produced remarkable results, as just this year violent and property crime are down 20% over the prior year.

Fourth point is homes and real estate values. Together, we formed a partnership with Habitat for Humanity seven years ago and have worked on improving over 300 homes since that time. We have raised over $4 million to support this effort and 26,000 hours of volunteer help have been provided by our faculty, staff and students. Housing values are up in this ZIP code area more than 300%, which is more than in any other ZIP code area in the Greater Phoenix metropolitan area.

Fifth, seven years ago, we started a free tutoring program that now impacts K-12 students in the city in over 300 different schools. GCU has over 1,200 students volunteering between 3:00 and 8:00 PM Monday through Friday in non-COVID time and between 10:00 AM and 6:00 PM on Saturday. Out of this program has grown a scholarship effort that we now have raised over $4 million to support.

GCU has awarded 360 full tuition scholarships to students that have come out of this tutoring program and achieved a minimum 3.5 GPA in high school. 100% of these scholarships have gone to students living below the poverty line, of which 95% are students of color. These efforts are continuing to gain real momentum and producing measurable results. As I said earlier, for a full description of the social responsibility efforts coming out of GCE and all of our partners, refer to the 10-K that has been recently released.

With that, I would like to turn it over to Dan Bachus, our CFO, to give a little more color on our 2020 fourth quarter, talk about changes in the income statement, balance sheet and other items, as well to provide 2021 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 and year ended December 31, 2020 and 2019. The non-GAAP amounts exclude the tax-effected amount of the amortization of intangible assets, the loss on transaction amounts and the impact of a large state tax refund received in the first quarter of 2019 related to taxes paid in previous years.

The amortizable intangible assets acquired in the Orbis acquisition totaled $210.3 million and the amortization expense in the fourth quarter of 2020 and 2019 was $2.1 million and $2.2 million respectively. 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 for the three months ended December 31, 2020 and 2019 is $1.89 and $1.63 respectively.

Service revenue exceeded our expectations in the fourth quarter of 2020, primarily due to higher-than-expected enrollments at our university partners. The increase in revenue per student year-over-year was expected and is primarily the result of GCU moving back the start of its ground traditional Fall semester such that there were five more revenue-producing days in the fourth quarter of 2020 as compared to the fourth quarter of 2019, which increased the service revenue we earned.

Additionally, our revenue is growing faster at our other university partners than at GCU and we generally generate a higher revenue per student on those services agreements than on our service agreement with GCU, as these agreements generally provide us a higher revenue share percentage, the partners have higher tuition rates than GCU and the majority of their students take on average more credits per semester as they're in accelerated programs.

These increases in revenue per student were partially offset by the approximately 4,900 of GCU's traditional campus students electing to attend the Fall semester entirely in the online modality due to COVID-19 concerns. As a result, 2020 Fall semester fees, room and board and other ancillary revenues for the fourth quarter of 2020 at GCU were lower than in the comparable period in the prior year, which reduced the service revenue we earned.

We estimate the shift in service revenue as a result in the change in the traditional Fall start date for GCU students from the third and fourth quarter of 2020 was $9.9 million. We estimate the reduction in service revenue attributable to reduced tuition fees and ancillary revenue for our university partners resulting from COVID-19 was $7.3 million in the fourth quarter of 2020. Included in both our 8-K and the 10-K filed today, there's a detailed explanation of the actual impact on all of our university partners' Spring, Summer and Fall 2020 semesters and our projected impacts for the Spring 2021 semester. I will discuss these in more detail in a few minutes.

Our effective tax rate for the fourth quarter of 2020 was 22.1% compared to 18.7% in the fourth quarter of 2019 and our guidance of 22.4%. The 2019 effective tax rate was lower due to some large one-time favorable discrete items related to state income taxes. We repurchased 437,544 shares of our common stock in the fourth quarter of 2020 at a cost of approximately $36.7 million and another 147,000 shares at a cost of $13.2 million subsequent to December 31, 2020.

At the January board meeting, the board approved a plan to utilize a significant amount of our 2021 cash flows from operations to repurchase shares, and in the last few months, our board of directors increased the authorization under our existing stock repurchase plan by $200 million such that, as of today, we have $235.1 million available under our share repurchase authorization.

Turning to the balance sheet and cash flows, total unrestricted cash and short-term investments at December 31, 2020, was $256.6 million. Our credit facility has an available line of credit of $150 million as of December 31, 2020. GCE CapEx in the fourth quarter of 2020 including CapEx for our new offsite classroom and laboratory sites was approximately $7.3 million or 3% of net revenue and was $29.4 million for the year, which was slightly below the $30 million to $35 million we had expected. Some of the CapEx for the new offsite campus classroom and laboratory sites that will be opened in 2021 was not incurred in 2020, as was expected, but will be incurred in 2021. We anticipate CapEx for 2021 to be similar to 2020.

Lastly, I'd like to provide color on the guidance we have provided for 2021. The guidance we have provided continues to be non-GAAP as-adjusted net income and as-adjusted diluted income per share, as we exclude the amortization of acquired intangible assets. As you have probably noticed, we have again provided estimates for each quarter of 2021. We do this because our financial results including GCU and the other partners that we service are seasonal.

Our enrollment guidance assumes GCU enrollment growth will moderate slightly over the course of the year to approximately 6.7% at the end of 2021. This assumption consists of total online enrollment growth rate moderating over the course of the year to 7% by year-end. Online new enrollment growth is projected to be up mid to high single digits depending on quarter, with the exception of the second quarter, which we predict will be flat year-over-year due to a very difficult comp caused by COVID.

And total online enrollments will be pressured over the course of 2021, especially the first quarter due to graduation year-over-year increases that exceed total enrollment growth as a result of accelerations in new start growth 15 to 18 months prior and lower reenters as a percentage of total enrollment than in the prior year due to the higher retention rates in 2020.

Ground enrollment is projected to grow to 20,200 in the Spring and 23,400 in the Fall, while we are currently anticipating Summer ground enrollments will be down slightly year-over-year to 6,400. The ground enrollment growth rate continues to be pressured by a significant decline year-over-year in professional study fees, working adults that take courses on ground primarily at GCU's traditional campus, as we have not had entry points for these potential students due to COVID.

Residential students will be down 3% year-over-year to approximately 11,600 in the Spring, as 3,500 students chose to take all of their courses online due to COVID-19 concerns. Our guidance assumes, though, that residential enrollment will be up 38% in the Fall to approximately 15,800. Other partner enrollments will grow to 4,500, 4,200, 5,800 and 5,100 at the end of the first, second, third quarter and end of the year.

As a reminder, GCU's off-campus healthcare students, which we anticipate will grow to over 200 by the end of 2021, are included in the GCU number and are not included in the other partner enrollments. And year-over-year, other partner enrollment growth rates will be impacted by the non-renewable contracts, which I will speak about in a second, and accelerating OTA graduates. These other partner estimates assume that three new sites are opened in the first half of 2021 and another four to five new sites are opened in the second half of 2021.

An OTA program that was planned to be opened in the Spring 2021 has been moved back to the Fall of 2021. We estimate that the revenue per student from our contract with GCU will be up year-over-year primarily through the growth in residential students in the Fall semester. But this will be partially offset by the impact of the lower residential enrollment in the Spring semester due to COVID-19 concerns of $5.7 million; $4.5 million in the first quarter and $1.2 million in the second.

We anticipate offsite healthcare partner revenues, including GCU offsite healthcare locations, will grow to $136 million in 2021 due primarily to the enrollment growth, partially offset by the fact that we and a former partner mutually agreed that their service agreement would not be extended upon its termination. This partner was one of

Orbis' initial partners and it had a financial arrangement that was different than Orbis' other clients. Excluding the revenue in 2020 from that contract, this would represent 25% revenue growth year-over-year.

On the expense side, we anticipate that expenses will accelerate beginning in the second quarter as compared to the last nine months of 2020 as expenses such as travel and medical benefits return to normal. These expenses were significantly below our expectations beginning near the end of the first quarter 2020 through the first quarter of 2021.

We anticipate that Orbis will be EBIT profitable excluding intangible amortization of approximately $4 million. Orbis' EBIT excluding the intangible amortization in 2020 was approximately $2 million, which was better than the EBIT breakeven that we anticipated. This is primarily due to approximately $2 million of investment for new site openings in the first half of 2021 that we expect to be incurred in 2020 being pushed back to 2021.

In addition, Orbis' EBIT is impacted by the non-renewal of the contract discussed earlier and the planned seven to eight new site openings in 2021 and another one to three in Spring 2022. The timing of site openings is heavily dependent on the timing of regulatory approvals. We anticipate technology and academic services, counseling services and support, marketing and communications, and general and administrative expenses will be approximately 14.9%, 27.3%, 19.5% and 4.2% of net revenues, and thus consolidated operating margin will be 34.1% of net revenues.

The second half margins assumptions could prove to be conservative. But given the continued uncertainty caused by COVID, we believe they're appropriate. Included in our guidance is the interest income on the note from GCU of approximately $59 million in 2021, down slightly from $59.2 million in 2020. We are aware that the university is working on refinancing part or all of that note, but no pay-downs are factored into our guidance.

If the university does refinance part or all of the note, it will have the effect of lowering interest income, but we hope to offset the impact on earnings per share with lower shares outstanding. We estimate interest expense will be approximately $3.1 million compared to $4.4 million in 2020, due to our pay-downs on our outstanding loan. We anticipate very little other income due to the lower interest rate environment.

Our guidance assumes an effective tax rate excluding potential contributions made in lieu of state income taxes to be 21.7% in Q1, 24.7% in both Q2 and Q3, and 24.5% in Q4, which excluding contributions in lieu of state income taxes made in 2020 is down slightly from 2020 due to a slightly higher estimated excess tax benefit deduction in the first quarter of 2021 than in first quarter of 2020.

As was mentioned earlier, the board of directors has approved the plan to increase the repurchase of shares. The weighted average shares outstanding amount takes into account our best estimate of the stock that will be repurchased, but does not take into account any shares that will be repurchased on a refinance by GCU.

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

QUESTION AND ANSWER SECTION

Operator: Certainly. [Operator Instructions] Our first question comes from the line of Jeff Silber from BMO Capital Markets. Your question, please.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.

Q

Thanks so much. I want to first focus on the GCU ground campus. I know it's still a little early to talk about the Fall and there's still a lot of uncertainty left. But any color that you can give in terms of recruiting, and I'm specifically interested if the issue with the Department of Education has impacted recruiting at all? Thanks.

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

A

I'll answer the second one first. No, that has not impacted our recruitment at all. Our current students, 95 – 99% of them don't know anything about it and really don't care much about it both on the ground and online side. And so, no, there's been no indication that that has had any impact on GCU's recruitment. The metrics that we have used for the last eight years to determine where we might end up in the Fall obviously are all different now, because students and families are way behind in their campus visitations and in their decision-making.

We're doing our best to look at reduced number of applications, but increased conversion rates to registrations. And those kind of numbers look very good for us. Last year, our goal for new enrollments in the Fall was 8,000, and we ended up with over 8,200. And we had some difficult months in there. This year, our goal is 9,000. And since the metrics are different, we have to do a little bit of guestimating. But based upon very strong conversion rates, even with less applications, we believe that we have a very good chance to hit the 9,000. And we are really picking up in campus visitations.

The first half of the year, it was a lot of the virtual tours and the virtual live labs and a lot of that interaction. And now, the actual visitations are really picking up, and we expect them to really pick up in April and May. The second semester of this year on our campus, we eliminated the spring break and we are going to do the last two weeks of class online, which will in essence clear our campus out at the end of April. And that is going to – I'm sorry, at the end of March, at the end of March and first week of April. That will free up our campus to be open to what we hope is mass visitations. In fact, we are actually going to probably combine for a lot of students their campus visitation with orientation.

And so, our activities are limited as compared to prior years, but extremely active as compared to our competition, extremely active as compared to our competition. So, given our low tuition rate, all the information now that students and parents are being bombarded with in terms of how much less our parents are taking out in terms of parent loans, how much less our students are taking out in terms of student loans, how many of our students are graduating in 3 and 3.5 years, all of those things, we believe, will lead to very high conversion rates, and we have – we believe that we have a very good chance to hit our number in the Fall.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.

Q

All right, that's really helpful. Let me shift gears over to Orbis. Appreciate the call you gave on profitability for both last year and what you're expecting this year. Can you just remind us, when you get through the kind of ramp-up in terms of new partners, where could Orbis go, what kind of profitability should we be expecting from that business longer term? Thanks.

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

A

The mature campuses – once a campus mature, which is – they start to reach maturity in year three, we expect 30-plus-percent margins on those locations for GCE. And so – and that's proving to be true as campuses are maturing.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.

Q

Okay, that's helpful. I'll go back in the queue. Thanks so much.

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

A

Thank you.

Operator: Thank you. Our next question comes from the line of Jeff Meuler from Baird. Your question, please.

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

Q

Yeah. Thanks. Hey, Brian, on the kind of changing the way you're talking about the platforms and consolidating three and four into three, I guess are you only open to doing non-healthcare online program management for university clients that you're also doing the Orbis model for or are you still open to that as a separate service? Just I guess what's the ideal client look like? What are you willing to do in that regard?

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

A

Well, the ideal client would be one that – and think about this in phases. As we open up these locations, we are really focusing on the ABSN program first. It's a proven model. We're going to need 1 million additional nurses in the next five years. The payoff, the value created for both the university and the student and GCE/Orbis is known. And we just repeat what we've been doing through them for 11 years. Second then, we will add some new healthcare programs to those campuses, occupational therapy, the nurse practitioner program, et cetera. As that's happening, we will start to open GCU locations, GCU/Orbis locations in the West. We'll start with the ABSN program, but those locations will grow faster in terms of additional healthcare programs and potentially other non-healthcare programs.

We think that as we have – as we prove that model out through the GCU/Orbis locations that other universities will want to take that up as well when they have the kind of programs that we have that prove to work. This is absolutely a play on the third major market now, we believe, in higher education. There are traditional students having an educational experience and a social experience on traditional campuses. That's our ground campus. There are students that are going back as working adults and doing their entire programs online. And then, there are college graduates, and there's a lot of evidence that in the last 10 years so many of them are underemployed, who are looking for a different format, one that combines delivering didactic material online with intense laboratory work in a physical brick-and-mortar location.

And it's those – it's that market and those programs that we're going to build this third foundation on. And so, it'll go in phases. But I think it will accelerate when GCU opens up its campuses and is a little bit more aggressive in terms of additional programs and additional non-healthcare programs. I think I mentioned it in the script, but other universities are now seeing some of our partners progress to 13-plus-percent of their revenues coming from these programs. And some of these partners haven't even been with us for a long period of time. Given the financial stress the universities are going to be experiencing, I think they're going to be really open to this market. And as we prove – as we continue to prove the results that – it'll go fast. I don't know. Did that help?

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

Q

Yeah, it did. And then, on the – there was a comment, I think, from Dan. I'm not sure who's best-equipped to answer this. But – so, on the potential for GCU to refinance the counterparty loan with GCE. Is it – I think you said a possibility of a partial refi. Can you just clarify that, because I would think that with the counterparty note having the campus and assets of the university securitized against it, that would be challenging? So, any additional color there? And then, am I interpreting it correctly, Dan, that on top of the significant percentage of the free cash flow that you're planning to use to repurchase stock that if there's proceeds from debt refi that you would also use a significant part of that debt refi proceeds to repurchase stock?

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

A

Yes, Jeff. What you just said is correct. In terms of the refinance, we've had conversations on and off with GCU about what they would like to do. And we have talked to our legal counsel and bankers and their legal counsel and bankers. And if ultimately they come to us and request to refinance, let's say, half of the debt, we would be open to that if that's what's in their best interest. So, I think it'll be a significant portion or all if they do complete a refinance this year, and I know they're working really hard on it, given the very low interest rate environment that exists.

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

Q

Understood. Thank you.

Operator: Thank you. Our next question comes from the line of Greg Pendy from Sidoti. Your question, please.

Gregory Pendy
Analyst, Sidoti & Co. LLC

Q

Hey, guys. Just two questions. I think earlier in the commentary, you mentioned a bigger focus on certifications. Could you elaborate? We know that nursing has sort of the NCLEX pass rate. But are there any particular other pathways with certifications that we should be thinking that you're looking to grow your mix in?

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

A

Yeah. What I was referring to is not kind of non-degree certifications, but degree programs that require that a student meets state and local requirements. So, when you think about first year teachers, working adults that are re-careering to become elementary and secondary school teachers, a lot of those things require specific state requirements. And if you don't have a huge infrastructure in place to manage that for students, you can't expect them to work that out on their own. There's just too many loose ends that they won't be able to tie together. And we've put together technology to help them do that.

The same is true for counseling programs, whether they're at the bachelor's level or the master's level. Many of those counseling programs, other things like counseling require that students from a state-to-state perspective are able to meet the local requirements. And we are able to counsel students in very specific ways about how they can move to our programs and make sure they're doing what is necessary to meet their state requirement. That's a difficult thing to manage. But it's a huge advantage for us, because most universities will just tell students, this is our program, you figure out whether this is going to meet the requirements in your state or not.

We don't do that. We take care of all that upfront for students and then we make sure that they get their fingerprint requirements fulfilled that they are scheduled to do their internship hours, that they're scheduled to do their observation hours, that they're scheduled to do their student teaching. All those things give us a huge leg-up when students are trying to complete degrees in those programs because we have the infrastructure to support it and we don't put students out there on their own to make sure that those things happen.

Gregory Pendy
Analyst, Sidoti & Co. LLC

Q

Okay. That's helpful.

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

A

So, it's more of that licensure requirement specific to degree programs than it is non-degree programs.

Gregory Pendy
Analyst, Sidoti & Co. LLC

Q

Got it, got it. And then, just one more, if I can add. You gave some metrics on Orbis, just the cost typically $30,000 to $60,000 and the starting salary is $50,000 to $100,000. But just given the change in administration, just kind of curious, thoughts on if gainful employment were to come back, given your traditional student at Orbis sometimes already incurred four years of a traditional college debt and then if you – not that your program is a lot. But if they were to add that on top of their four years of undergraduate debt, if that poses any sort of a risk given the way the gainful employment was under the prior administration – or I should say under the Obama administration?

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

A

Yeah. It's so interesting and it is such a new and emerging market. Students that are in their 20s, late-20s, they've completed academic degrees, they're underemployed, they have – they are working at jobs that don't even require a degree. How do you help them get re-careered? They don't want to have the experience of going back to campus as an 18-year-old. But the programs that they're interested in that really pay off frequently have not only requirements to study online, but also have lab requirements associated with them.

And the ABSN program is the most obvious. We're going to need 1 million additional nurses. Universities aren't going to step up to do that. And so, we need new and creative and very flexible models to help students do that. And most of those students, in our Orbis program, are not taking out Title IV loans. They are taking out private loans and private companies are stepping up to do that because there's a 90-plus-percent graduation rate and students are passing the NCLEX at 90-plus-percent rate, and they're stepping into jobs that pay between $60,000 and $80,000. And so, you can't – you probably can't get a better loan if you're a bank than that student – than that loan.

And so, eventually, as GCU opens up these Orbis locations, we'll probably implement more Title IV at least for partial of the money that they're going to need, but we're going to stay in programs where the career path is clear, where the jobs are available and where the income levels are significant. As a result of that, we don't anticipate any issues there. This is a major new market that's emerging here. And it's going to have a big impact on students' decisions in the coming years that are 18-years-old in terms of what degree programs are they choosing and what do they know about the investment they're going to make, the career path that's going to be available to them, the income that they can make, et cetera.

It's not as big a deal at GCU as it is other universities, because our students graduate with such little debt. But we still are going to talk to them about – even our students at GCU ground campus, we're going to talk to them about career earning potential and those kind of things, because universities – many universities are stuck in a faculty model that kind of forces them into offering certain programs that have a rich history to them, but are not nearly as in demand and lucrative as they used to be. But you've got tenured faculty that have those positions and those courses have to be taught. And so, we're in a very different place, don't have nearly that kind of pressure, and so we could do it at GCU. But we also believe that we can help other universities do it through GCE. But no, we don't anticipate the – any issue with regards to gainful employment.

Gregory Pendy
Analyst, Sidoti & Co. LLC

Q

That's helpful. Thanks a lot.

Operator: Thank you. Our next question comes from the line of Brett Knoblauch from Capital Markets (sic) [Berenberg Capital Markets]. Your question, please.

Brett Knoblauch
Analyst, Berenberg Capital Markets LLC

Q

Hey, guys. Thanks for taking my question. Just regarding the nursing shortage, where is the bottleneck there? Is that more on the university side from them not having capacity or is it maybe in the hospital side? Maybe they don't have enough capacity to employ nurses. I guess where is the bottleneck building up?

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

A

Yeah. It's the sacred cows that exist within the history of higher education. Nursing schools are heavily dependent on the first-time pass rates on the NCLEX exam. Your nursing school rating is heavily dependent on those things. And the surest way – and even our dean would admit this at GCU, the surest way to make sure that you get the kind of first-time pass rate on NCLEX exams is to make it very – your program very small and elite. And so, in many programs, you take – you come in for your first two years and you take biology and chemistry and physiology, those kinds of courses and you need to come out with a 3.9 GPA after your first two years to get into nursing school, when it's very obvious to us that a 3.6 GPA student can absolutely get through the second two years of nursing school and become gainfully employed as a nurse.

And so, part of it is the desire to – for nursing school rankings on the part of the dean. The second part of it is that nursing schools are very expensive to offer. Typically, they lose money. The laboratory investment is significant. The student to faculty ratio is very low. And so, schools don't have any incentive to grow their nursing programs because they lose money on it. And so, the incentive for nursing schools to take the operational risk to expand and grow to meet the demand is not there. We have never been afraid of that. This year 2020 – I'm glad you asked this question. I can't be – I can't tell you I'm speaking on behalf of GCU now as its President. But in the middle of the pandemic, we produced far more nurses than any of the state universities that exist in Arizona and we had a 95.6% first-time pass rate on the NCLEX exam. It was a phenomenal year in the middle of a pandemic.

And the third thing – and I didn't mention about why can't they scale – is that you're limited in terms of clinical placements. And that's a very real thing. It's not the nursing schools issue. The first two are the nursing schools' issue. The third one is not. But in the middle of this pandemic, GCU's nursing program worked with our Nursing Board to put in place simulations that we invested a lot of money in to replace certain clinical hours. And that happened in the middle of all of what was going on with the pandemic. And so, the investments were made, adjustments were made and students got their clinical work done, which I just am extremely proud of how GCU responded to that and how GCE was supportive of all that.

But those are the three major reasons. The Orbis program is going to aggressively challenge or become a solution to the issues that I indicated, and we really believe that the country will be tremendously benefiting from what we do in terms of nursing populations, but also nurse practitioners which are – there's a shortage of, occupational therapists which there are shortage of, all those things, we think, Orbis is in a very strong position to help resolve those issues.

Brett Knoblauch
Analyst, Berenberg Capital Markets LLC

Q

No, perfect. That helps a lot. And then, maybe just one more question. Just curious to what you're seeing from the graduate side of things. Do you think we're going to have a – maybe a changed environment coming out of COVID, where online is much more acceptable from a graduate degree perspective? And do you expect that to result in maybe sustained growth there from the graduate online degrees exposure that you have?

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

A

Yeah. I think in large part, we've moved past, where did you earn – did you earn your degree on a campus or did you earn your degree online? I think we've moved past a lot of that. The more appropriate question now is, what area did you earn it in? The generalist kinds of degrees at the undergraduate level, if you go back to complete your program in business management or if you go back and competed in another liberal arts area, that's not going to be nearly as impactful or necessary for people. And the same is going to be true at the graduate level.

If you said to a person right now, do you think you'd benefit more by doing an MBA program or a master's degree in cybersecurity? Right now in this country today, there are 300,000 open jobs that pay on average $92,000 a year for master's degrees in cybersecurity. And so, understanding where the economy is going, where the job shortages are, where the clear career paths are to good income is far more important than did you do it online or did you do it on ground. And I think that's – we're putting a major focus on understanding where the economy is going and growing those programs that specifically relate to where the jobs are going to be versus is it delivered online or is it delivered on ground.

Now, I'd tell you the exciting thing for me is, yes, healthcare, even at the graduate level, but eventually, we would like to take these students that have baccalaureate degrees and help them earn second baccalaureate degrees in mechanical engineering, in electrical engineering, in those areas, because that's going to be, for a lot of people, a lot better than going back to earn a master's degree in business for example. Not for everybody, but for a lot of people. You hear a lot of talk about the people that can do things as well as know things are just going to be a lot more desired in the marketplace.

Brett Knoblauch
Analyst, Berenberg Capital Markets LLC

Q

Perfect. Thanks so much.

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

We have 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.

Operator: Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.