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Grand Canyon Education, Inc. (LOPE)

Q3 2023 Earnings Call

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OTHER PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, and thank you for standing by. Welcome to the Grand Canyon Education Third Quarter 2023 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 your first speaker today, Dan Bachus. Dan, please go ahead.

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

Thank you. 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 risk 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. Thank you for joining Grand Canyon Education's third quarter fiscal year 2023 conference call. GCE had a remarkable quarter, exceeding enrollment expectations by producing online new starts that were approximately 20% over prior year in our largest start period of the year; and also producing greater-than-expected retention numbers, exceeding revenue guidance estimates at midpoint by $2.4 million and producing an $0.18 beat in adjusted diluted earnings per share to consensus.

Judging by these results and the lead flow for the months of September, October and November, there has never been greater interest in what is happening at Grand Canyon Education and its partner, Grand Canyon University, as well as the other 24 partners.

An article that recently appeared in Fortune magazine titled, the labor shortage is pushing American colleges into crisis, with the plunge in enrollment the worst ever recorded. Author Collin Binkley says the following, nationwide, undergraduate college enrollments dropped 8% from 2019 to 2022, with declines even after returning to in-person classes, according to data from the National Student Clearinghouse. The slide in the college-going rate since 2018 is the steepest on record according to the U.S. Bureau of Labor Statistics. Economists say the impact could be dire. Fewer college graduates could worsen labor shortages in fields from health care to information technology.

The trend has continued into 2023, according to The Chronicle of Higher Education, with freshman enrollment dropping 6.9% at public four-year institutions and 4.7% at private nonprofit institutions.

Grand Canyon Education and its 25 university partners are experiencing significant growth in spite of declines in the overall market. And I believe that growth will continue for the reasons I will explain as I review the four platforms we use to deliver higher education.

First, the online campus at Grand Canyon University. New starts were up approximately 20% over the third quarter of the prior year, and total enrollment growth significantly exceeded our expectations and it is now up 8.3% over the prior year. There are many reasons for this, but I want to highlight four.

One, we have stayed hyper-focused on opportunities that exist in today's labor market and, since the beginning of the pandemic, have rolled out 116 new programs, emphases and certificates across the 10 colleges at GCU. These programs are tied directly to labor market opportunities for students and accounted for 8.1% of the new students that started in the third quarter. One of the responses of universities to the declining enrollments during the pandemic was to reduce the number of programs they offered.

Number two, we continue to work with employers directly to address their workforce shortages. This effort is focused on the industries of education, healthcare, technology, public safety and the military. In the third quarter, new starts from this work increased 33%.

Three, the retention of students in the third quarter went up 40 basis points, which we believe continues to improve because of the relevancy of the programs that students are entering.

Number four, GCU has resisted responding to the slower growth during the pandemic by raising tuition, which many institutions have done. Online net tuition increases since 2018 have averaged approximately 1% per year. October online new enrollments remain strong. And thus, we are now expecting new enrollments in the fourth quarter to be up in the low to mid-teens year-over-year.

Second, GCU ground campus for traditional students. Enrollment was in line with what we expected when we gave guidance last quarter. At the same time, the number of traditional-aged students starting GCU's programs online between April and September was higher than we expected as well. As I discussed last quarter, there is a clear trend here that we are uniquely positioned to respond to.

Working adult students, post-pandemic, are more inclined to work from home and to do higher education from home. This may become a trend for traditional-aged students as well. 5,631 traditional-aged students started GCU programs online between April and September, which is up 21.5% over the same time last year. These students may come to campus eventually or may do the entire program from home. These students are traditional-aged students, but we are currently counting them in our online campus numbers.

Early indications for the fall of 2024 indicate GCU's traditional, on-campus enrollment, we believe, will return to its normal growth trajectory based on Discover GCU visits being up year-to-date over 30%.

Because of our significant advantages, including a very low price point, very low average debt levels, percentage of students completing in less than four years and the relevancy of GCU academic programs, we anticipate that GCU will benefit from both trends.

We will continue to focus on the growth of traditional students attending our campus with the goal still being 50,000, and also focus on traditional-aged students across the country who want to do their academic work from home. We anticipate revenue generated from the ground traditional students will be up in the mid-single digits in the fall semester of 2023, as compared to the fall semester of 2022.

Third, Grand Canyon Education's hybrid campus had a declining enrollment year-over-year of 4.3% in the third quarter. However, we believe the hybrid campus has turned the corner. New fall enrollments were up in the high-single digits year-over-year, and we expect the new enrollment growth rate in spring of 2024 to be even higher. There are two main reasons for this.

One, all but one of our active ABSN partners have responded to the younger students interested in ABSN programs by admitting advanced standing students this fall or are in the process of making that change. Students with partially completed degrees haven't accumulated a great deal of debt and are very interested in nursing careers, but didn't have an efficient way to earn their prerequisite science course work. GCU created the science courses and some other gen ed courses, so they could be delivered online in eight weeks. Students can access these courses from anywhere in the world.

There are start opportunities almost every week. These courses have been made very affordable, are taught by experienced faculty, class sizes are low, and there's a tremendous amount of academic support, including an artificial intelligence project that went live in October, which provides students 24/7 access to tutoring.

Since we implemented these courses, we have enrolled approximately 5,500 students. We have a waterfall report that allows us to know how students are progressing through their prerequisite courses and when they will be eligible to start at one of our ABSN sites.

The success rate of students who successfully enter our ABSN programs is 90%, and the first-time pass rate on the NCLEX exam remains approximately 90%. We now have an extremely efficient way to get students academically eligible and prepared to enter the program. We saw positive results in the fall semester, and we believe it will get even better from there.

Fourth, the Center for Workforce Development at Grand Canyon University. In the 2022-2023 school year, we started 80 students in electricians' pre-apprenticeship program in partnership with companies that are experiencing labor shortages in that area and are excited about hiring our graduates. The program consists of four, four-credit courses and runs one semester. 74 students successfully completed the program. This upcoming school year, we will start 220 students in the program and expect the same results. 119 students started in this program in the fall, and we expect a similar number in the spring of 2024. We also have plans to begin offering this program at one of our locations outside of Arizona in 2024.

This fall, we also started 19 students in a manufacturing certificate program. GCU is running a small parts manufacturing business on campus that is doing work for some of the major companies in Arizona. These students are going to school for 20 hours a week and then work in a facility as a paid employee for 20 hours. At the end of the semester, they will receive a manufacturing certificate and be eligible for employment in Arizona's fast-growing manufacturing industry. GCU's growing engineering college also has students assisting with this project. Once this concept has been successfully proved out, we expect to work with GCU to scale this program and then add others.

I started out talking about the fear that exists around future labor shortages in key industries as a result of the declining enrollments in higher education across the country. In the five-plus years since GCE has become a service provider, it has helped its partners accomplish the following. In that time, GCE has helped Grand Canyon University graduate 146,015 students; 39,776 in education, including 19,062 first-time teachers at a time when teacher shortages have created a national crisis.

41,220 in nursing and healthcare professions, including 2,080 pre-licensure nurses, at a time when there is a huge shortage of nurses. 28,308 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 25,286 graduates. The College of Science, Engineering and Technology has grown by 246% and provided 5,528 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 five-plus years since GCU has become a nonprofit institution and GCE has become an education services provider.

Service revenue was $221.9 million for the third quarter of 2023, an increase of $13.2 million or 6.3%, as compared to $208.7 million for the third quarter of 2022. The increase year-over-year in service revenue was primarily due to an increase in GCU enrollments of 6.6% and an increase in revenue per student year-over-year.

Operating income for the three months ended September 30, 2023 was $41.5 million, an increase of $6 million, as compared to $35.5 million for the same period in 2022. The operating margin for the three months ended September 30, 2023 was 18.7%, compared to 17% for the same period in 2022.

Net income increased 19.1% to $35.7 million for the third quarter of 2023, compared to $30 million for the same period in 2022. GAAP diluted income per share for the three months ended September 30, 2023 is $1.19. As adjusted, non-GAAP diluted income per share for the three months ended September 30, 2023 is $1.26.

With that, I would like to turn it over to Dan Bachus, our CFO, to give a little more color on our 2023 (sic) [2023 third] quarter, talk about changes in the income statement, balance sheet and other items, as well as to discuss the updated 2023 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 September 30, 2023 and 2022. The non-GAAP amounts exclude the tax-affected amount of the amortization of intangible assets of $2.1 million for the third quarters of both 2023 and 2022 and the tax-affected amount of the losses on fixed asset disposals of $0.4 million and $0.5 million for the three months ended September 30, 2023 and 2022, respectively. We believe that 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 September 30, 2023 and 2022 is $1.26 and $1.02, respectively.

Service revenue was higher than our expectations in the third quarter of 2023 due to the higher-than-expected enrollments at GCU and some of our other university partners. 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 share (sic) [student] for hybrid ABSN students generates a significantly higher revenue per student than we earn 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.

The increase in revenue per student was also positively impacted in the third quarter of 2023 by year-over-year differences in the timing of the GCU traditional campus' fall semester, such that $1.2 million shifted from the fourth quarter to the third quarter as compared to last year.

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

We also plan for a significant increase year-over-year in travel and employee benefits as these amounts were significantly lower than pre-COVID levels in the prior year. We also plan 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.

Our effective tax rate in the third quarter of 2023 was 19.3%, compared to 17.2% in the third quarter of 2022 and our guidance of 18.6%. The third quarter 2023 effective tax rate was favorably impacted by the contributions in lieu of state income taxes of $3.9 million (sic) [$3.5 million] and $5 million in July 2023 and 2022, respectively. The slightly higher-than-expected tax rate in the third quarter of 2023 was due to the contribution in lieu of state income taxes, having a less-than-expected impact on the effective tax rate due to the higher-than-expected income before taxes.

As a reminder, the contribution in lieu of state income taxes has the effect of increasing general and administrative expenses in the third quarter this year by $3.5 million and lowering income tax expense by the same amount, but only 75% of the $3.5 million in the third quarter and the remaining 25% in the fourth quarter.

We repurchased 306,239 shares of our common stock in the third quarter of 2023 at a cost of approximately $33.7 million, and another 81,943 shares were repurchased since September 30, 2023. We announced today that on October 25, 2023, the company's board of directors increased the authorization under its existing stock repurchase plan (sic) [program] by $200 million and extended the current expiration date to March 1, 2025. We have $272.4 million remaining available as of today, which includes the increase in October 2023, under our share repurchase authorization.

The board and the company intends to continue using a significant portion of its cash flows from operations to repurchase its shares. But share repurchases in future years will be less than in 2021 and 2022 as we utilize all the proceeds from the repayment of the secured note during those years.

Turning to the balance sheet and cash flows. Total unrestricted cash and short-term investments at September 30, 2023 were $154.4 million. GCE CapEx in the third quarter of 2023, including CapEx for new off-campus classroom and laboratory site, was approximately $16.6 million or 7.5% of service revenue.

We expect CapEx for 2023 to be approximately $40 million, which is more than our original projection of between $30 million and $35 million. The slightly higher CapEx is partly due to higher spend on internal IT projects and due to a couple of the new off-site locations occurring slightly higher than expected tenant improvement costs.

I would now 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 the component to adjust the GAAP amounts to non-GAAP as adjusted net income and non-GAAP as adjusted diluted income per share. In addition, as requested by a number of our investors, we have included in the guidance section of our 8-K filed today, the non-GAAP as adjusted diluted income per share estimate.

We have updated full-year 2023 guidance to include the third quarter revenue and earnings beats. As I will discuss in more detail in a minute, we have also raised and narrowed the revenue and operating margin ranges for the fourth quarter based on current enrollment and spending trends. We have also updated our expected fourth quarter effective tax rate. These changes have resulted in a $0.11 increase in EPS estimates for the fourth quarter of 2023 at midpoint and a $0.57 increase in full-year EPS estimates at midpoint from the original 2023 estimates.

As Brian mentioned earlier, we anticipate total enrollment to be higher in the fourth quarter than our previous estimates, which should result in higher-than-expected tuition revenue in the fourth quarter.

As a reminder, the second half revenue is being negatively impacted by contract changes going into effect for a couple of our other university partners that I discussed on prior calls in which we will no longer reimburse those partners for certain costs and, as a result, have agreed to reduce the contractual revenue share percentage. These changes impact both the third and fourth quarters, but have a much bigger impact on the fourth quarter than the third quarter as they went into effect with the start of the fall term.

There have been no material changes in our expense expectations for the fourth quarter of 2023. We have slightly lowered our effective tax rate for the fourth quarter of 2023 to 20.3% from 21.3%. Our weighted average shares guidance assumes that we purchase additional shares similar to what was used to purchase shares in the third quarter, 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 that it uses to evaluate, including the ratio of enterprise value to adjusted EBITDA and the free cash flow yield, rather than the multiples of other education companies. As although we can be viewed as being in the same sector, there are few, if any, appropriate comps.

On an enterprise value to adjusted EBITDA basis, the stock is currently trading at roughly 12.1, which is less than the recent S&P average of 16.4. The average free cash flow yield for the S&P 500 is 2.8%, whereas the company's free cash flow yield is approximately 5.8%.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. At this time, we will conduct the question-and-answer session. [Operator Instructions] Please stand by while we compile the Q&A roster. Our first question comes from Jeff Silber with BMO Capital Markets. Jeff, go ahead with your question.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.

Q

Thanks so much. Wanted to focus, first, on GCU online enrollment. Really impressive numbers in terms of the accelerated growth there. Can you just give us a little bit more color what drove that and how sustainable that is going forward?

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

A

Yeah. A couple of things drove it. One, the work that we're doing with school districts, hospitals, counseling centers, military bases, people are really, really focused on giving opportunities to their employees that are operating at lower levels in the organization. And so, that was up 33% this quarter over the same quarter of the prior year. That work is having a major impact for organizations, and the word is spreading that we have the capability to do that. And so, that is a major driver.

As you know, that work was all shut down for the time during COVID, but we didn't lay those people off. And when the country opened back up, we were poised to, really, play a significant role for a lot of school districts, hospitals, et cetera. So that's part of it.

Secondly, in the months of September and October especially, well, even prior to that, we saw the efficiency of our marketing spend go up. A lot of people that – universities, as we were entering this summer, started to predict that their enrollment number was not going to hit and that their revenues were going to be down significantly. And people stopped spending in terms of advertising, if you're not making any money or not successful in a few programs that you're delivering online, we just saw withdrawal. People started to get out.

And so, I think the combination of all the new programs we opened, there's so much interest in the new programs. The work that we're doing directly with companies to help give people opportunities to move up, paraprofessionals becoming teachers and people moving up in the nursing profession. Cybersecurity specialists on military bases. It was that, plus the efficiency of the marketing spend, that drove the increase. And at this point, we absolutely think it's sustainable.

The months of September, October and November from a lead flow standpoint, just the amount of interest, and so much of it is really, really high-quality stuff; people doing their own searches, looking for opportunities. And there just isn't anybody out there that has the breadth of programmatic offerings that we do.

So does that help?

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.

Q

Yeah. No, that's actually very helpful. Maybe if we can switch over to the hybrid program. You cited the strong new fall enrollment growth and your expectations for spring to be even higher. What are you seeing that's giving you that confidence?

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

A

Man, it's primarily our university partners adjusting to the fact that the market changed. And there's a significant amount of interest in people becoming nurses, but it's really for people who are younger and that have partially completed degrees. It's not mainly for people who have completed degrees and are looking to re-career into nursing. There's still some of that. But the huge growth is in people that are at community colleges, who have 20, 30, 40 college credits. They haven't accumulated much debt and they're very interested in a nursing career.

And so, that adjustment and then the prerequisite course offerings, I mean that was just a huge change because there was no efficient way that was affordable for people to get into those courses, especially the science courses; other gen ed courses as well, but especially the science courses. And GCU put together – really, 10 courses are the big part of it, but there are some additional ones – put a lot of time and energy into those courses, hiring full-time faculty to teach them, providing tremendous levels of academic support, and we've already had over 5,000 students take those courses.

And so, now, no matter where you are in the country, you can enroll in those courses within a week or two. And one of the things that surprised us is that there are a lot of 20, 21-year olds that are only part-time employed that aren't taking one of those courses at a time; they're taking multiple courses at a time because most of them are only working part-time jobs. But it's the clear path from getting that science course work completed, getting into an ABSN program to do the 60 credits at the upper division level, that clear path has really changed this thing tremendously.

If you're in a market and somebody tells you to go to the community college and see what they have to offer, or that's just a long, difficult, arduous process that de-incents people. And so, we think now we've got a great solution to – the first obstacle was the clinical placements, and we fixed a lot of that in the last couple years. And now, the second obstacle was that science prerequisite course work. We believe we've impacted that significantly. And so, we're excited now about the next couple years.

Jeffrey M. Silber
Analyst, BMO Capital Markets Corp.

Q

All right. That's really helpful. I'll jump back in the queue. Thanks.

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

A

Thank you.

Operator: Please stand by for our next question. Our next question comes from Jeff Meuler with Baird. Jeff, please go ahead with your question. Jeff Meuler with Baird? Stand by.

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

A

We can move to – there's another Baird. So maybe he's on the next – try to get the one that says Gabriel.

Operator: Our next question comes from the line of Gabriel Diederich with Baird. Gabriel, go ahead with your question.

Gabriel George Diederich
Senior Vice President & Portfolio Manager, Robert W. Baird & Co., Inc. (Fixed Income)

Q

Sure. Thank you for the call today. I actually work in a different department than Jeff, but really appreciate the comments. And was just curious on your thoughts regarding the recent fine with the Department of Education. Any thoughts on impacts for the organization and just how that communication and dialogue is going for the company?

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

A

Yeah. We've been dealing with the department for five years. And so, we'll continue to deal with it. We knew that there was – fine was coming, and so we got out in front of it and made sure that we told our part of the story. None of what's going on makes any sense from a logic perspective. We went through a very lawful process to return to a nonprofit institution. That went really, really well. The department, for some reason, denied our nonprofit status. We don't know what the reason is. They don't tell us. And then, for four years, we try to fix it. Eventually, had to file a complaint. And as a result of that, the retaliation started.

And so, it's something we have to deal with, but it's not going to stop what we're doing. Things are going unbelievably well here. The desire for what we have, which is four very, very creative platforms, where we can deliver education to students based on what their living situation is, their life situation, based upon what the nature of it is, they need to learn. We can deliver it extremely efficiently. We can do it without major tuition increases, without huge debt levels. We can just do it in an extremely high-quality way. And the focus on free speech at a Christian University is very, very attractive to Americans throughout this country.

And so, we're in a great spot, and we're going to continue to focus on delivering to students, delivering to organizations, making sure that people are in a position to get a great return on their investment of time, energy and money. And so, it's something we have to deal with, but it's not something that's going to slow this thing down at all.

Gabriel George Diederich
Senior Vice President & Portfolio Manager, Robert W. Baird & Co., Inc. (Fixed Income)

Q

Thank you.

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

We have reached the end of our third 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: Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.