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Grand Canyon Education, Inc. (LOPE)

Q2 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Second Quarter 2020 Grand Canyon Education Earnings Conference Call. At this time, all participants lines are in a listen-only mode. After the speakers' presentation, there'll be a question-and-answer session. [Operator Instructions] Please be advised that today's conference is being recorded. [Operator Instructions]

I would now like to hand the conference over to your speaker today, Mr. Dan Bachus, CFO. Please go ahead, sir.

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 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 will 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 second quarter conference call. We are now 24 months into our existence as an education services company. I want to do three things on this call. First, continue to emphasize how we think GCE should be positioned with respect to the future of higher education; second,

review the results that have been produced by each of the four pillars of our business in the second quarter of 2020; third, talk about each pillar going forward in the context of the pandemic.

I want to continue to emphasize that it is GCE's goal to create models that address the real issues within higher education that are going to be even greater challenges given the impact of the pandemic. The challenges are. One, the out of control rising cost of the university education; two, the increasing student debt levels that will seriously hinder graduates as they begin their adult lives; three, as tuition level goes up, diversity on college campuses goes down; four, bachelor's degree should not take four to six years to complete; five, programs and delivery models lack the creativity 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.

We are very excited about GCE's direction relative to the challenges facing students, families and the industries we are serving. In 2020, GCE's 25 partner institutions project to produce over 30,000 graduates, over 11,000 healthcare professionals, 7,700 education professionals, 4,600 in the business world, 3,600 in behavioral health, 2,500 in public service, social science and theology, and 600 in engineering and computer science. These students will graduate with less Title IV debt than the average state and private university students in this country. They will have less than a 6% cohort default rate on student loans. Will graduate from programs that pass the previous debt-to-income earnings ratios that were part of the gainful employment rules, and less than 75% of the revenues that are generated will be from Title IV programs.

Now, I would like to review the four pillars of GCE's business. Grand Canyon University Online at 87,959 online students as of June 30, 2020, and in the quarter just completed new students grew in the high teens while total students grew 8.2% year-over-year. We have definitely seen an acceleration of working adult students enrolling in our programs online. As this acceleration has taken place, the percentage of students that are studying at the graduate level has actually gone up.

GCE continues to work with GCU to ensure that student growth takes place at levels and in programs that will produce high-quality outcomes, namely students that graduate at high percentages, make meaningful contribution to the workforce, and pay back reasonable loan amounts. GCE's core business margin expanded 150 basis points in calendar year 2019, with a net tuition increase that average less than 1% at GCU online.

This is important for three reasons. GCU's online tuition remains affordable and represents good value for our students relative to the positive impact it will have on their careers. Two, it will allow GCE to continue to invest in advanced learning, counseling, and administrative technologies, as well as roll out at least 20 new academic programs per year. Three, a major factor contributing to GCE's success in the midst of this pandemic is that we had previously set up over 95% of our staff to be able to work-from-home. Initially, this was put in place as a benefit of working at GCE. This represents part of the \$250 million we have invested in technology and automation in the last 10 years.

In the case of the pandemic, we could easily transition almost everybody to a work-from-home environment, and this is expected to continue for the foreseeable future. All the work done previously from a campus/office setting continues from a home setting, and in every case, productivity levels has gone up.

In the second quarter, applications were processed at 117.9% of the prior year. 28,268 transcripts were evaluated, which is up 17.1%. There are now 2,123,069 million (sic) [2,123,069] (00:06:00) courses in our transcript evaluation system, which is up 33.2%. Let me read that again. There are now 2,123,069 courses in our transcript evaluation system, which is up 33.2%. There are now courses from 4,406 academic institutions in that

system, which is up 163.4%. There were 221,689 financial aid files touched at a 97.2% compliance quality rating. There were 569,351 counselor activities performed on behalf of students, which is up 27.6%. There were 75,987 field experience counselor activities performed for students in licensure programs, which is up 32.29%. There were 227,460 electronic signature documents executed, which was up 16%.

Staff morale levels are high. Working from home not only ensures their continued employment but allows many of them to be home with their children while they are out of school. Not only have there not been layoffs or salary decreases, but we were able to provide annual salary increases, which our staff are very grateful for. The new enrollment trends will most likely normalize to mid- to high-single-digit growth in the third quarter, which given the large comps that exist in the third quarter, is still significant growth. But because of the quality of the incoming student's persistence rate, we anticipate a year-over-year total enrollment growth trends should continue through the quarter.

The second pillar is the GCU traditional campus. As many of you know, GCU Ground students finish the last four weeks of the spring semester in an online learning environment. All ground faculty and students were on the system and using it to some extent before the transition. As a result, the transition was very seamless, and student satisfaction levels with that experience were high. All students received a grade for each of their classes as we did not have to resort to a pass-fail system.

This encouraged 6,650 students to continue in the online learning environment to complete summer classes. By taking summer school courses and also because of our large dual credit program for high school students, over 40% of our graduates complete their degree in less than four years. Many additional students could graduate in less than four years. However, they choose to add a second major or work on a graduate degree.

It is important to note that GCU's traditional campus is profitable without raising tuition in 12 years, and has invested over \$1.5 billion in academic and other campus infrastructure. The campus currently ranks as the 19th best college campus in the nation according to Niche.com. There will be an additional \$500 million investment in the next four years, which GCU is able to accomplish with its cash reserves.

New and continuing enrollments look strong for the fall semester. The university's goal for new on-ground students was 8,000 and that goal will be exceeded. The university's goal for total enrollment will also be exceeded as a result of increased spring to fall retention. This is in stark contrast to what many universities in the country are experiencing.

On July 17, GCU announced its plans for the fall. Those plans include moving back the start of instruction for the fall semester from August 24 to September 7. The semester will begin with three weeks of online instruction for all students. GCU's faculty is very confident that given their considerable experience with their robust online learning system, they can get students off to a very strong start academically.

Residential students will move in during the week of September 20, beginning face-to-face instruction on September 28. Some holiday breaks will be eliminated, and there will be an additional week of instruction in December. The change in the start date for GCU's ground traditional students will have the effect of moving tuition revenue for all GCU traditional students and certain ancillary revenue for residential students from the third quarter of 2020 to the fourth quarter of 2020; and a change in the move-in date for GCU's residential students will reduce fall/semester room and board revenue for the university by three weeks.

The university made these changes for two reasons. One, Arizona has become a hot spot for the coronavirus, and we wanted the state to flatten the curve and become a safer destination for students. Two, the later arrival on

campus puts the majority of the intense heat in Arizona behind us and allows us to conduct many activities in an outdoor environment. The goal is to create the same vibrant academic and community experience within the context of safety precautions that will be necessary because of the pandemic.

Students that are not comfortable returning can register to take all their classes online in the fall. At this point, a little over 3,000 students will remain home and take the fall semester classes online. We anticipate that number will grow as we get closer to the start of the semester. We believe this is a very positive trend as these students are not dropping to attend local universities or taking gap years. They are staying with the university and progressing towards graduation.

Their room reservation will be held for them so they can come on campus in the spring if they feel more comfortable. There has been a lot of talk about students not wanting to pay private or out-of-state tuition to go to college online. Given GCU's low-ground campus tuition, that has not been raised as an issue. Ground enrollment trends for the fall 2021 are very strong. At this point in time, the ground campus is running 81% ahead of last year's application rate.

There were some observers who predicted that the GCE/GCU partnership would produce good financial results for GCE, but would not work financially for GCU. They were very wrong. The university has now completed its second year as a standalone nonprofit university. The university publicly made available its financial statements for the year ended June 30, 2019, that showed the university had over \$325 million in cash on its balance sheet and had net assets of over \$387 million at June 30, 2019, and its cash flows from operations for the year ended June 30, 2019, were over \$123 million.

The positive results for the university continued in the year ended June 30, 2020. Based on preliminary financial statements provided to us by GCU and with the GCU has authorized us to discuss, the university's cash balance at June 30, 2020, was approximately \$308 million. Its net assets grew to almost \$410 million. It generated \$116 million in cash flows from operations during the year ended June 30, 2020. The university plans to continue using its excess cash to fund its continued growth and pay down its debt. This was all done without tuition increases on the ground campus and a less than 1% increase in net tuition on its online campus. It should also be noted that the pandemic is not having a negative financial impact on the university given the structure of the MSA with GCE.

The third pillar of the GCE strategy is Orbis. This purchase greatly accelerated GCE as an education services company, and it addresses issues that have hurt many of the other OPMS. Orbis fits in the GCE's strategic plan because it originated as a result of a huge marketplace need. The US will need 1 million additional nurses in the next five years alone, as well as thousands of nurse practitioners and occupational therapists, and is using a very innovative delivery model. Orbis like GCU Online and GCU Ground will be profitable. The profits will be reinvested into Orbis to create more opportunities, both in terms of locations and adding programs to current locations.

Self-sustaining economic models that don't rely on taxpayer's subsidies, endowments or other philanthropic donations are a huge benefit to the economy and state budgets. Orbis's growth has been greatly accelerated as a result of GCE's considerable support. Since we bought Orbis, seven university partners have been added. And as of today, we are up to 25 total university partners, including our first university partner for a new medical lab science program and what will be our first prelicensure program in California.

At the date of the acquisition, we had 18 sites opened among 11 of Orbis Education's university partners. As of today, we have expanded to 23 sites locations opened at 14 of Orbis Education's university partners. Additionally, we plan to open 11 sites last/locations in the next 12 months, seven in the fall of 2020, and four in the spring of

2021, which would put us at 34 locations in the spring semester of 2021. By the end of 2021, we expect to have approximately 40 locations opened.

The creative delivery model, which combines on-ground laboratory work with online delivery of course content, is producing tremendous outcomes for students, the healthcare community, and university partners. Thousands of Americans will be able to pursue their dream of becoming healthcare professionals, making tremendous contributions to the healthcare industry because of these partnerships. GCE will continue to support Orbis with capital, marketing, and operations support, including advanced technologies.

In terms of metrics, the graduation rates are approximately 90%, and first-time pass rates on the NCLEX exam are consistently over 90%. GCU's nursing program in the last four quarters produced 95% or higher, first-time pass rates.

Orbis revenues grew 24.2% on a year-over-year basis for the three months ended June 30, 2020. Enrollments have grown 12.2% year-over-year as of June 30, 2020, with accelerated pre-licensure nursing enrollments growing 18%.

Every new location open represents an opportunity for GCE that has greater potential than most other OPM contracts in the space. Each location open requires less than a \$3 million investment and will turn profitable in its second year of operation, eventually producing greater than 30% margins, which can be reinvested into adding more programs at the site and opening more sites. The goal is to be in 70 locations in the next seven years.

To summarize, we are very focused on this Orbis opportunity for five reasons. One, the huge need the country has for healthcare professionals, especially baccalaureate-prepared nurses; two, the opportunity to grow into 70 potential locations; three, the locations will become profitable in just their second year of operation; four, the relatively small amount of investment needed to get locations up and running; fifth, these Orbis programs are tremendously beneficial to the financial well-being of the university partners.

All of the Orbis partners have moved students through their individual university programs during the summer term. At this time, we have confirmed that all of our partner programs intend to continue delivering quality healthcare education in the fall and beyond. The academic delivery in the current environment has been challenging, and the Orbis team has been working with our university partners to find successful operational modifications to continue success with the student population that will become essential professionals within our communities.

The Orbis team has been involved in several developments within various programs including but not limited to virtual simulation, lab modifications, logistic and operation support for curriculum timing adjustments within a term, alternative testing. Some of these developments may become standards within programs as they improve the educational experience and efficiently deliver content to students.

Even with all of the successes Orbis and our university partners have recently achieved, there will still be some short-term impact on the summer and fall terms. A number of students that plan to start in the summer term that were relocating out of state chose to defer their start until the fall, decreasing the new start amount in the summer by approximately 20%. Overall, demand for the programs has increased as more potential students see healthcare as a solid option for employment.

In a number of locations, demand that start in the fall is greater than the initial planned fall intake size. But a number of our university or healthcare partners have chosen not to increase the fall cohort size to make up for the

summer start shortfall due to concerns about clinical availability. Therefore, it appears that Orbis fall enrollment will be lower than our original expectations. Although due to higher retention rates and slightly higher expected new starts, we expect to make up some of the summer new start shortfall. The interest level from potential university partners has also increased. The demand to be a future Orbis partner is strong.

GCE's fourth pillar is to find three or four partners interested in a more comprehensive arrangement. Since the pandemic began, there has been an increase in university inquiries for possible partnerships, mostly universities asking for assistance with improving the quality of what they are doing online with their traditional students and growing their working adult programs given that many universities are concerned about their financial future. We continue to work at this pillar but we'll continue to be selective. The model of many partners, many low enrolled programs at very high price point is not interesting to us because the model doesn't fundamentally address the real challenges identified earlier in higher education.

We believe we can add tremendous value to university partners in the Midwest or Northeast, and are in dialogue with a number of them. Most of them have had partnerships in the past that have not been successful. We are willing to help universities improve the frontend academic experience for their traditional students. But our strategy of frontend services combined with robust backend services is clearly a differentiated approach that can help universities looking to scale their working adult programs. The model we are suggesting is proven on a very large scale.

GCU's hybrid campus, having large student bodies in both major markets leveraging a common infrastructure, has been successful in unprecedented ways. High-quality students producing great outcomes and great value combined with making huge investments to constantly upgrade infrastructure is a matter of the fact [ph] not (00:21:46) opinion. Everybody that visits a GCU campus goes away very impressed.

Our other three core pillars are performing well, have great potential, and as a result, we have the ability to be selective. If we find the right comprehensive partner, we will sign an agreement. If you look at the strategy of other OPMs in the space, those contracts would most likely be dilutive rather than accretive to our current plan. In addition, the huge upfront investments of these arrangements would play a significant risk into our current business.

With that, I would like to turn it over to Dan Bachus, our CFO, to give a little more color on our 2020 second quarter, talk about changes in the income statement, balance sheet, and other items as well as to provide 2020 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 June 30, 2020 and 2019. The non-GAAP amounts exclude the tax-affected amount of the amortization of intangible assets, the loss on transaction amount, 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 amortization expense in the second 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 June 30, 2020, and 2019, is \$1.03 and \$1.09, respectively. Service revenue significantly exceeded our expectations in the second quarter of 2020 primarily due to the acceleration of GCU's online enrollments during the second quarter. In addition to the high-teens new enrollment growth, drops were down 6.1% year-over-year, which more than offset the year-over-year increase in graduation.

As was anticipated, we realized a decrease in ancillary revenues between years at our primary university partner, GCU. GCU moved all summer semester classes to an online environment in the last week of March and limited residential students remained on campus during the summer semester. Most doctoral residencies were canceled through June, and ancillary businesses operated by GCU such as the hotel and merchandise shops were closed due to the COVID-19 outbreak.

We estimate the impact of all of these changes made by GCU, as well as the Orbis new start shortfall, reduced our revenues by \$7.5 million in the second quarter. Included in both our 10-K and the 10-Q filed today is a detailed explanation of the actual and projected COVID-19 impacts on the university spring and summer and fall 2020 semesters, and I will discuss these in more detail in a few minutes. Revenue per student was down year-over-year due to the lower ancillary revenues at GCU. Excluding the COVID-19 impact on GCU's ancillary revenues, revenue per student grew year-over-year.

As we have discussed previously, overall enrollment growth has been pressured over the last few quarters by an increase in the graduation of online students year-over-year and the fact that professional study students and ground commuter students are flat to down year-over-year, while revenue per student continues to increase as we continue to see very encouraging growth in the areas of our focus, including online, residential, and Orbis enrollment where revenue per student is the highest.

Our effective tax rate for the second quarter of 2020 was 24.6% compared to 21.7% in the second quarter of 2019 and our guidance of 24.2%. In the second quarter of 2020, the effective tax rate was impacted by higher state taxes primarily due to the growth in Orbis and lower excess tax benefit of zero in the second quarter of 2020 as compared to \$2.2million in the same period in 2019 due to a lower stock price and lower stock option exercises in the second quarter of 2020.

We repurchased 111,100 shares of our common stock in the second quarter of 2020 at a cost of approximately \$8.3 million and another 23,800 shares at a cost of \$2.1 million subsequent to June 30, 2020. We had \$58.3 million available under our share repurchase authorization as of June 30, 2020. In July 2020, the board of directors increased the share repurchase authorization to \$300 million, extended the authorization date to December 31, 2021, which increases our available repurchases to \$106.2 million as of today.

Turning to the balance sheet and cash flows, total unrestricted cash and short-term investments at June 30, 2020, were \$187.2 million. GCE CapEx in the second quarter of 2020 including CapEx for new Orbis partner sites was approximately \$6.1 million or 3.3% of net revenue. We continue to anticipate CapEx will be between \$30 million and \$35 million in 2020 due to the planned opening of seven new locations at fall 2020 and four more in the spring of 2021 as compared to the five locations that were opened in the same period in the prior year.

As a reminder to investors, the note due from GCU was secured by all of its assets. Given this, it is very difficult for the university to get financing from any other source than GCE. Thus, we have committed to allow them to borrow for short-term cash needs and to fund capital expenditures. GCU has informed us they have the ability to fund its capital expenditures going forward, but they requested and we provided \$75 million of funding for short-term cash flow purposes at the end of the second quarter of 2020. At the time of the borrowing, CGU paid it's

June 2020 estimated service fee and interest due on a secured note receivable of \$50 million and \$4.8 million, respectively, thereby reducing the accounts receivable and interest receivable on our consolidated balance sheet as of June 30, 2020.

The \$75 million that was borrowed in June 2020 was repaid in July 2020. And GCU returned to its practice paying the service fee and interest due on the secured note for the month in arrears. GCU paid the estimated service fee and interest due on the note in June 2019 as well. So, the impact on cash flows for the change in accounts receivable and interest fees receivable between years is not material.

Last, I would like to provide color on the guidance we have provided for 2020. The company initially provided guidance for fiscal 2020 by quarter in its fourth quarter and full-year 2019 earnings release issued on February 19, 2020. The company provided revised guidance for the second quarter 2020 with its first quarter 2020 earnings release, which took into account our best estimate at that time of the impact of the COVID-19 outbreak on our university partners revenue and operating income for their spring and summer semesters but withdrew its guidance for the second half of 2020 due to the uncertainties of the impact of COVID-19 on its university partners fall semesters.

Today, we have reinstated guidance for the third and fourth quarters of 2020 based on what we know as of today. Although we caution investors that uncertainties around the fall semester remain. The guidance that we have provided for the second half of 2020 continues to be non-GAAP as adjusted net income and as adjusted diluted income per share as we exclude amortization of acquired intangible assets. We have adjusted our revenue and earnings guidance for the third and fourth quarters of 2020 to take into account the items Brian mentioned earlier.

The change in the fall semester calendar for GCU's ground traditional students will have the effect of moving tuition revenue for these students and certain ancillary revenue for residential students from the third quarter of 2020 to the fourth quarter 2020, and the change in the move-in date for GCU's residential students will reduce fall semester room and board for the university by three weeks.

We are also projecting lower service revenues from GCU's businesses such as the hotel, which will be closed through the end of the calendar year; and Lope Shop, which will see decreased operating activity. The university will also recognize less revenue as most of the doctor residency schedules, we held on the university campus have been canceled through the end of July, and this is likely to continue through the end of the year.

Our estimates also include our best guess as of today of the number of GCU's residential students that will live on campus in the fall, which is less than originally projected as almost 3,500 students have informed the university that they plan to take all of their fall semester courses online due to COVID concerns.

Orbis revenues in the second half of 2020 have also been reduced due to the summer new start shortfall discussed earlier. We estimate that the shift in revenue from the third to the fourth as a result of the shift in the start day of the GCU fall semester is \$9.9 million lower revenue in the third quarter and \$9.9 million higher revenue in the fourth quarter. We estimate that the impact of the lost summer and fall semester ancillary revenues, as well as the Orbis summer new start shortfall totals \$20 million in the second half of the year, \$13.1 million in the third quarter, and \$6.9 million in the fourth, although we anticipate that the higher-than-expected online and ground traditional enrollment at GCU will make up for most, if not all of this lost revenue.

Even if face-to-face instruction begins in the fall, as currently planned for our partners, there could be an additional decrease in revenue on the GCU MSA that is not included in the estimates provided of a higher

percentage of students that estimated decided not to live on campus but rather take all of their classes in the fall semester online or take the semester off, or if a significant number of Orbis education partner students decide to delay their start from the fall to the spring semester.

On the expense side, we have not changed our expense projections materially with the exception of the \$5 million of contributions made in lieu of state income taxes that were made in July 2020, which I will discuss in more detail in a minute. We do anticipate lower travel and other costs during the third and fourth quarters, but we plan to utilize the majority of these costs – these dollars in other ways to ensure that we meet our partners' enrollment expectations.

Our net interest expectation in the third and fourth quarters are \$14.2 million and \$14.4 million, respectively, which is consistent with the original estimates as although interest expense will be lower than originally projected so will interest income on invested cash, both due to lower interest rates.

We have decreased our original effective tax rates for the third and fourth quarters. In July 2020, we made \$5 million of contributions made in lieu of state income taxes, which has the effect of increasing general and administrative expenses and decreasing income tax expense. The entire \$5 million is recorded as G&A expense in the third quarter while three-quarters or \$3.75 million is recorded as lower state income tax in the third quarter and a quarter or \$1.25 million is included as lower state income tax in the fourth quarter.

This net of recent trends which includes higher state income taxes and a lower excess tax benefit result in our revised effective tax rate of 20.7% in Q3 and 22.4% in Q4. We have decreased our weighted average shares outstanding amount based on stock repurchases. Although we might repurchase additional shares during 2020, these estimates do not assume repurchases other than those already made.

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

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Jeff Silber with BMO Capital Markets. Your line is open.

Jeffrey M. Silber

Analyst, BMO Capital Markets Corp.

Q

Thanks so much. Quite a lot of information there. Let me start with the growth or the accelerated growth in the – your working adult students online, very impressive in this environment. Can we get a little bit more color on that? Specifically, I'm just curious, is it more disproportionately graduate versus undergrad, and what is the mix between grad and undergrad? Thanks.

Brian E. Mueller

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

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Yes, it is. We watch that very carefully. That's a big part of the GCU Online strategy. We really want to keep the graduate/undergraduate mix – well, if you think of graduate students, it's 50%. Then if you include RN-to-BSN students, which they behave a lot like graduate students in terms the outcome, is a great deal more than 50%. What happened as we had the high teens growth rate of new starts in April, May, and June is that the percentage weight of graduates went up around 2%. But the fact that it just – it went up was very, very significant because when you look at persistence rates between grad students and undergrad students, especially in the online environment, when you can engineer your student body that way, you're going to produce really, really high graduation – or metrics – really good metrics. I didn't include it in our call, but it was interesting that our – this quarter, our growth in graduates exceeded our growth in enrollment, which is a really, really significant number from the standpoint of the quality that we're producing from a student standpoint and from an academic perspective.

Jeffrey M. Silber

Analyst, BMO Capital Markets Corp.

Q

That's great. I'm sorry.

Brian E. Mueller

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

A

The other question was...

Jeffrey M. Silber

Analyst, BMO Capital Markets Corp.

Q

More focused on the undergraduate side. Did you see the starts from undergrad go down or they just didn't go up as much as the starts from grad?

Brian E. Mueller

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

A

No, they didn't go down. They didn't go down. They just didn't go up as much as the graduates did. We're talking – now we're talking online students.

Jeffrey M. Silber

Analyst, BMO Capital Markets Corp.

Correct, correct.

Q

Brian E. Mueller

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

Right, right.

A

Jeffrey M. Silber

Analyst, BMO Capital Markets Corp.

Okay. Good. Thank you for clarifying that. Moving on to how you're setting up the campus for the fall semester. Obviously, we've seen your disclosure. A number of schools are doing a number of different things. From a safety – health and safety perspective, can you give us a little bit more color what plans you have in place if, God forbid, there is an outbreak on the campus?

Q

Brian E. Mueller

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

Well, yeah, what we thought was going to produce – our students want to be back here. I was having student meetings, with having parent council meetings, and it was just our students want to be back on this campus. And so, given that huge demand, we thought the best thing to do was, number one, move back the start date. At the very time we were making this decision, Arizona was going through a – there was an increase, and we became a hot spot. We did – the Governor did some things that we thought would work, and they have been working. They are working, so the curve is starting to flatten, and things are looking better. So, we thought by moving the actual move-in date to the last week of September, we would get two things happen. We'd get a flattening of the curve. And second, we would get the majority of the heat behind us so that we could take advantage of October, November, and December so students could be outside for all kinds of activities.

A

What we're doing in addition to those things is, number one, each class will meet once on-ground and then a second time synchronously online during the course of the week so that in every classroom, only half the classroom chairs will be filled. Every single classroom has now been equipped with technology – additional technology so that if the faculty member doesn't feel well and needs to Zoom in or video in their lecture, they can do that. But if a classroom is equipped for 50 students, there will only be 25 students in that classroom. There will be social distance. A mask will be required. And faculty members will be protected by – with additional kinds of equipment. That's really, really important to us.

And in talking to student leaders, our student council, I just kept emphasizing that I know that they are not as vulnerable, but it takes an entire community to run this campus. So, we have faculty members, and we have security, we have maintenance, we have cooks. And many of those people are in vulnerable age brackets, and we just need to keep the entire community safe.

We've not changed anything with regards to residence halls, but two-thirds of our students do have their own bedroom because we are an apartment-style living that will help. We are going to put a limitation on visitors. We do have a closed campus. Our campus does not intertwine with the community. And so, it gives us a chance to control who's on campus, and so that will help.

We are building a lot of outdoor shade areas. We're moving – we've got 32 restaurants, but seating is all going to be outdoors. It's going to be shaded. The intramural activities will be noncontact activities. The chapel services,

which usually put 7,500 people in our chapel, we'll put in four different locations and we'll – and so we'll make use of technology in four different locations to keep social distancing. I think that's most of the things that we're going to be doing.

We do have 1,200 of our student leaders who provide leadership in residence halls, RAs, and life leaders. They'll be showing up three weeks earlier, and they'll – early, and they will be working with us in establishing the right kind of culture. We want the kids to have a great academic experience. We want them to all progress towards their degrees. We don't want any additional cost for them. We don't want them to incur additional costs in order to do that. But we also know that a hallmark of GCU is the community. If you ask 10 kids why they came here, it's because they love the closeness of the community, the inclusiveness, and all of that. And so, we're going to try to create circumstances so that they can enjoy that experience. Does that help?

Jeffrey M. Silber

Analyst, BMO Capital Markets Corp.

Q

Okay. I'm sorry. No. I was going to say I appreciate the details. I'll get back in the queue. Thanks so much.

Brian E. Mueller

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

A

Okay. Thanks.

Operator: Thank you. Our next question comes from Jeff Meuler with Baird. Your line is open.

Jeffrey P. Meuler

Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. Thank you. Good afternoon. So, curious on your comments about the online new enrollment growth potentially going from that really strong upper teens to I think you said mid- to high-single-digit in Q3. I understand the high teens likely is not sustainable for an extended period of time, but just why would it normalize that quickly because it seems like the demand environment for the population that you serve and your execution in this environment are good, and not clear to me why that would kind of go back to the longer-term trend line as quickly as Q3?

Brian E. Mueller

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

A

Well, you have to remember that the pandemic hit at a perfect time for that high teens to happen because April, May, and June are not as high of enrollment months as July, August, and September. And so, the fact that there was all this demand at a time when most people couldn't answer the phone, and we were answering the phone on the first ring, and this is both ground and online, caused a lot of students to come here that maybe they were thinking about going someplace else. And it happened at a time when enrollments aren't typically as high as they are in the next quarter. And so, the timing of that was just very, very good.

As people went back to work to some extent then things normalized a little bit, but we're still in a strong position. If we get high teens growth in the third quarter given the toughness of those comps, that would be very good. And that's going to be – as we said, that's going to be also helped by the fact that the persistence rates of the students that we're putting into the program are going the high. And so, high teens, new enrollment growth will produce a strong [indiscernible] (00:43:17) enrollment growth and we think put us in a strong position.

Daniel E. Bachus

Chief Financial Officer, Grand Canyon Education, Inc.

A

Other things I would add, Jeff, is obviously we're very early in the quarter given that August and September are individually the largest start months of the year. So August is the largest and September happens to be the second largest. So, we're early on. From a raw new start perspective, the momentum is not slowing. But when you take those huge, huge year-over-year comps, it's just a slightly smaller year-over-year increase than a similar number attached to the second quarter numbers. So, we're not – I don't want anyone to think that we're seeing a slowing in momentum. It's just a much, much, much more difficult comp given that August is our largest start month of the year and September is our second largest.

Daniel E. Bachus

Chief Financial Officer, Grand Canyon Education, Inc.

A

And we tend to, over the years, underpromise and try to overdeliver.

Jeffrey P. Meuler

Analyst, Robert W. Baird & Co., Inc.

Q

Noticed. So, on Orbis, can we just revisit that? So, I know that previously you talked about the typical relocation wasn't occurring in the summer and you were thinking there might be an opportunity for your partners to make up some of those enrollments in the fall. And it sounds like maybe some of them are, but there's some number of partners there that just are not increasing their expectations relative to what they were previously expecting to take in, in the fall. So still – so is that right? But – so still good growth but you're just not getting kind of that catch-up from the deferred summer enrollment? And then are those students at this point likely lost for your university partners?

Brian E. Mueller

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

A

The demand is there. The students want in but the – and the university has the capability of bringing them in. They're concerned about the [ph] clinicals (00:45:31). And so, it's the second aspect of their education where they don't know that they can scale, and some are more conservative than others. And so, yes, the opportunity for catch-up is there except for the cautiousness of – but we might not be able to get an additional number of [ph] clinicals (00:45:55). Those things are all scheduled in advance and a year out. And so, if you want more of, those things are usually scheduled right after the – what hospitals think are the maximum. That was the problem.

Daniel E. Bachus

Chief Financial Officer, Grand Canyon Education, Inc.

A

And as I said earlier, we expect our full enrollment – our new starts on – in the full enrollment for Orbis to meet or exceed our original expectations. It just won't exceed enough to make up for the 20% shortfall in the summer start because of the things Brian just talked about.

Jeffrey P. Meuler

Analyst, Robert W. Baird & Co., Inc.

Q

Yeah. That's helpful quantification. And then – so lots of moving parts in the guidance. On the option of the GCU campus affiliated students to go online only for this semester for some period of time, it sounds like 3,500 at this point have indicated that preference at least for the first semester. Does the guidance assume 3,500, or does it assume a higher number? Because I heard you say you'd expect it to go up over time, but you also kind of called that out as a risk factor on the guidance.

Daniel E. Bachus

Chief Financial Officer, Grand Canyon Education, Inc.

Yeah. So, as of today, we're not quite at 3,500, but the guidance assumes 3,500.

A

Jeffrey P. Meuler

Analyst, Robert W. Baird & Co., Inc.

Okay. Got it. Thank you.

Q

Brian E. Mueller

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

Thank you.

A

Operator: Thank you. Our next question comes from Greg Pendency with Sidoti. Your line is open.

Gregory Pendency

Analyst, Sidoti & Co. LLC

Hey, guys. Thanks for taking my question. Just I guess in terms of the mix that you're seeing towards more graduate students, how should we be thinking about the impact, if any, on revenue per student that might have?

Q

Daniel E. Bachus

Chief Financial Officer, Grand Canyon Education, Inc.

For us, Greg, revenue per student is on a specific quarter between graduate and undergraduate is pretty much the same, maybe a little bit higher for graduate than undergraduate because tuition on average is a little bit higher, but undergraduate students historically have taken slightly more credits in a semester time period. So, they're pretty much the same. The big difference, as Brian alluded to, is just the persistence and graduation rates of graduate students, and degree completer undergraduate students is much higher.

A

Gregory Pendency

Analyst, Sidoti & Co. LLC

Great. Thanks. And then just one more. I mean, have you ever seen a period in time where sort of the ground-based students, is there any – it doesn't seem like you're seeing any to-date. But is there any sort of sensitivity to the economy you think that can work into a student's decision to maybe go purely online?

Q

Brian E. Mueller

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

Yes. We think that there will be – there are changes right now to how people think about going to college because of the economy. I speak at high school graduations, and it's amazing when I listen to the students moving across the stage, how many are going to a community college first and then they've already been accepted in a four-year institution two years down the line and so they're trying to save money. Some students are going online first and a local provider and then going to a more expensive state university or a private university. We are not seeing it. We're not seeing it because the average student at GCU's campus pays \$8,600 a year for tuition, and we haven't changed our tuition amount level for 12 years.

A

And so, like – people say to me, you're building out this 300-acre which will become a 400-acre campus, you're going to put \$500-million-more in four years into buildings, technology, laboratories. What we've learned is that

the appetite for students to go to college and have a residential community experience is greater than it's ever been. It just can't be \$60,000 a year. If you could provide it for \$8,600 a year, another \$8,000 for room and board, the students can graduate in three years. They love going to college. They love having that community experience. They love spending time with their professors in office hours. They love the network of friends that they make. And so, very honestly, with all the things we shared today, the number that is really incredible, it is flat now to some extent, but right now, for fall of 2021, our applications are 81% of where they were at the same time for 2020 last year.

And so, the demand – which is why, when we talk about our four pillars, the third – the second pillar, GCU Ground, historically in this country, it's always been assumed that you're going to lose money on a ground campus environment that you charge tuition. Whatever you don't get, you've got to raise in philanthropic donations, but you're going to lose money, and that's not the case.

Now it's only not the case if you have a hybrid campus, which means you're leveraging your infrastructure across 80-some-thousand online students, and then 24,000 at some point can become 35,000 ground students. But that – this ground thing is hugely working in our favor, and it's working in the students' behavior that are – favor in a huge way. So, the demand to come on campus and to have this experience, as long as it's affordable, that's not going away at all. For us, it's increasing.

Gregory Pandy

Analyst, Sidoti & Co. LLC

That's helpful. Thanks a lot.

Q

Brian E. Mueller

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

Yes.

A

Daniel E. Bachus

Chief Financial Officer, Grand Canyon Education, Inc.

We've reached the end of our second 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 participating. You may now disconnect. Everyone, have a great day.

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