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## Conference Call Transcript

APOL - Q2 2006 Apollo Group Earnings Conference Call

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Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

## CORPORATE PARTICIPANTS

**John Sperling**

*Apollo Group, Inc. - Acting Executive Chairman of the Board*

**Brian Mueller**

*Apollo Group, Inc. - President*

**Kenda Gonzales**

*Apollo Group, Inc. - CFO, Secretary, Treasurer*

## CONFERENCE CALL PARTICIPANTS

**Kelly Flynn**

*UBS - Analyst*

**Kirsten Edwards**

*ThinkEquity Partners - Analyst*

**Howard Block**

*Banc of America Securities - Analyst*

**Gary Bisbee**

*Lehman Brothers - Analyst*

**Mark Marostica**

*Piper Jaffray - Analyst*

**Jeff Silber**

*Harris Nesbitt - Analyst*

**Sarah Gubins**

*Merrill Lynch - Analyst*

**Corey Greendale**

*First Analysis - Analyst*

**Jennifer Childe**

*Bear Stearns - Analyst*

**Chris Gutek**

*Morgan Stanley - Analyst*

**Trey Cowan**

*Sanford Group - Analyst*

**Bob Craig**

*Stifel Nicolaus - Analyst*

**Greg Cappelli**

*Credit Suisse - Analyst*

**Mark Hughes**

*SunTrust - Analyst*

## PRESENTATION

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### Operator

Good morning, ladies and gentlemen, and welcome to Apollo Group Inc. second-quarter fiscal 2006 earnings conference call. (OPERATOR INSTRUCTIONS). As a reminder, ladies and gentlemen, this conference is being recorded today, March 23, 2006 and may not be reproduced in whole or in part without permission from the Company. There will be a replay of this call available through April 7, 2006, beginning approximately two hours after we conclude today. The replay number is 1-800-642-1687 or 706-645-9291 internationally. The conference ID for

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

the replay is 6340488. Additionally, this call will be broadcast over the Internet and can be accessed via the Company's website at [www.apollogrp.edu](http://www.apollogrp.edu).

I would also like to remind you that this conference call contains certain forward-looking statements with respect to the future performance of Apollo Group that involve risks and uncertainties. Various factors could cause the actual results of the Company to be materially different from any future results expressed or implied by such forward-looking statements. These factors are discussed in the Company's 10-K report filed with the Securities and Exchange Commission.

I would now like to turn the call over to Dr. John Sperling, Acting Executive Chairman of Apollo Group. Dr. Sperling, please go ahead, sir.

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**John Sperling - Apollo Group, Inc. - Acting Executive Chairman of the Board**

Good morning, everyone, and welcome to the second-quarter results conference call for Apollo Group. The results we're going to report are pretty much in line with what we have given as guidance. And to give you all the details on that, I'm going to turn it over to Brian Mueller, our President.

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**Brian Mueller - Apollo Group, Inc. - President**

Thank you, John. Good morning and thank you for your participation in the conference call this morning. As I've said very consistently during the past three weeks, we are in a period of transition as a company. We are not pleased to report a 9.5% increase in student enrollment for the quarter.

We are encouraged, however, by three things. There was a greater than 20% increase in online enrollment. We have the most scalable online program in the world, and we are in the process of training our entire enrollment staff to sell into the trend of more people wanting to do education online. We think that is encouraging.

Two, we underspent significantly in advertising as compared to the previous year. We are reversing that trend, and the early results are positive.

Thirdly, in spite of our revenue shortfall, our operating margins, excluding unusual expenses, actually increased. The transition period that we're going through is impacting our growth rate, but it is not having a significant impact on our margins and we expect that long-term, our historical margins will remain intact.

On the revenue side, I indicated three weeks ago that we had three factors that were negatively impacting our second-quarter performance. One, we had been taking for a while now a conservative approach to advertising. In the second quarter of 2005, we actually spent \$56.1 million and spent only \$49.4 million in the second quarter of 2006. We had to spend aggressively later in the quarter, even to get it to the \$49.4 million number. We have started to reverse that trend. In March, the lead flow is strong, especially at the local campuses.

Secondly, we had a \$17 million shortfall in revenue in December, because of the holiday schedule adjustments that were made and students deciding to take extended breaks. Many of those students came back in January and February, but not all of them returned. We will make the necessary adjustments next holiday season to avoid that happening again.

Thirdly, the percent of Axia students as a percent of all students continues to rise, which slightly impacts revenue. But we expect that process to start to reverse in the fourth quarter, as we begin to transfer students into the University of Phoenix from Axia College.

On the expense side, enrollment counselor expense was up as a percent of revenue, as we anticipate that our recent strength in lead flow will continue throughout the second half. Bad debt levels are stabilizing, and we expect them to go down in the fourth quarter this year and the first quarter of next year.

Three weeks ago, I said we would focus on topline growth in the second half, and would have three broad strategies. I want to give an update on those strategies.

The first strategy involves building our core business. We want to invest at historical levels and slightly beyond in sales and promotion in our core business of 24 to 45-year-old working adults. We expect that the downward trend in cost per lead will continue in the third quarter. The right pricing strategy of leads will begin to have an impact in the fourth quarter, and we think a major impact in the next fiscal year.

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

We are hiring enrollment counselors in the Midwest, in the Southeast and the Northeast, where lead flow is the strongest. The upgrade of our telephone systems and the completion of the technology necessary for full implementation of our qualifying center is on track, and should be completed by August 1st. All 2,400 online enrollment counselors are on the hot transfer system. We moved the Southern California campus on the system two weeks ago. We will continue to roll it out in the Western region in March and April, and hope to finish the entire country by August 1st.

We are still waiting approval on the Bachelor's programs in Psychology and Communications. The Master's Degrees in Psychology and Social Work are still under development.

The S3 scheduling system for academic counselors continues to roll out throughout the country, and a compensation plan to reward them for retention success is under consideration. And I hope to talk more about that in the fourth quarter.

We are expanding our reach into the 18 to 24-year-old market through Axia College. We believe our ability to be successful here is a key driver in our strategy to improve growth percentages. I indicated previously that we have four activities that we're working on. One, Axia College will come under the University of Phoenix by April 1st.

Secondly, we will have rolled out Axia to the Western region in April and we will be putting students into the program in May. We expect conversion rates to go up in California in the third and fourth quarters.

Thirdly, we will begin advertising for Axia directed specifically at the 18 to 24-year-old market in May.

And fourth, we will continue to work with students nearing Axia College graduation to transfer them to the University of Phoenix. We hope to have a large enough sample size in the fourth quarter to begin building models that we think will be good predictions for the future.

We continue to believe that our retention rate with Axia College students will exceed that of level one students put into the UOP program. The reasons are that one, the 20 months path to graduation is something that is considered achievable by those students. Secondly, younger students are comfortable with the technology. Thirdly, being able to work and go to school at the same time is important for students in that age group. And fourthly, the high levels of academic support we're going to be giving those students we think will increase our retention rate and increase our graduation rate.

The advertising.com partnership is going well. We are merging the technology systems. We're building process flows, and working with all our current vendors to transition them by May 1st. From May 1st until the end of August, we will be working to right-price leads and work toward improving significantly the quality of leads. The goal is to bring maximum efficiency to our Internet spending by combining right pricing with a total conversion to our qualifying center to improve significantly the conversion rates of our enrollment counselors.

That is kind of a high-level view of the quarter, and I'm going to turn it over now to Kenda to give you some specific information about the financial results.

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

Thank you, Brian. Revenue related to students enrolled in degree programs increased 12.6% for the second quarter of fiscal 2006 to \$526.7 million, compared to \$467.6 million for the second quarter of fiscal 2005. Discounts for the quarter were \$25.9 million or 4.3% of gross revenue.

Instructional costs and services increased as a percentage of revenue in the quarter ended February 28, 2006, primarily as a result of an increase in bad debt expense. Selling and promotional costs decreased as a percentage of revenue in the quarter ended February 28, 2006, primarily as a result of a decrease in advertising.

University of Phoenix currently has 67 local campus locations, of which 34 are less than five years old. 15 of these local campus locations are two years old or less, with 13 of these locations not yet at a breakeven for fiscal 2006.

Excluding the \$26.5 million related to our former CEO separation agreement, general and administrative expenses increased during the second fiscal quarter of 2006, as a percentage of revenue, due primarily to increased administrative space and depreciation costs, due to the opening of

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

the redundant data center. Our operating margin, excluding the amounts paid under the separation agreement and stock-based compensation expense, increased to 28.3% for the second quarter of fiscal 2006, compared to 27.6% for the second quarter of fiscal 2005.

Turning to the balance sheet, cash and marketable securities were \$433 million at February 28, 2006. Net receivables were \$200.7 million, which equates to 30 days sales outstanding. At February 28, 2006 we had reserved \$28.5 million against our receivable balance, and during the second quarter of fiscal 2006 we wrote off \$17.3 million of student receivables. Between February 28, 2005 and February 28, 2006 the current portion of deferred revenue increased 13.5% to \$125.5 million, and student deposits increased 3.4% to \$261.1 million.

Cash flow from operations for the first six months of fiscal 2006 was \$260.3 million, compared to \$229.9 million for the first six months of fiscal 2005. Capital expenditures net of the online land and building transactions for the first half of fiscal 2006 were \$15.4 million, compared to \$43.9 million for the first half of fiscal 2005.

During the second quarter of fiscal 2006, we purchased 3,548,000 shares of APOL. At the end of the quarter, we had \$140.1 million remaining of the amount authorized by our Board of Directors for stock buybacks.

With that, I think we're ready to turn it over for questions, operator.

## QUESTION AND ANSWER

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### Operator

(OPERATOR INSTRUCTIONS). Your first question comes from Kelly Flynn, UBS.

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### Kelly Flynn - UBS - Analyst

A question for Brian. I appreciate that you don't want to give guidance, but I was hoping you could just maybe give kind of broad guidance on where you think marketing spend could go relative to where it has been historically. I think you have made some comments recently about that at some conferences, but maybe just clarify what levels you think were baseline in the past, and how much above that you might go.

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### Brian Mueller - Apollo Group, Inc. - President

Yes. What I have said at conferences in the last number of weeks is that our levels will be pretty close to historical levels, and maybe slightly beyond that, but not significantly beyond that.

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### Kelly Flynn - UBS - Analyst

I appreciate that you gave out online enrollment number this quarter -- can you tell us what it was for the first quarter, what the growth was?

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### Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer

I believe it was in the neighborhood of -- let me look it up. I don't want to misquote it. 34%? Yes, 34%.

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### Operator

Kirsten Edwards, ThinkEquity Partners.

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### Kirsten Edwards - ThinkEquity Partners - Analyst

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

Good Morning, for the redundant data center that you mentioned, is that something that is temporary, so we should see that go back to the 4% of revenue?

**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

No, we built a redundant data center. It opened late in the fourth quarter of last year. So we began depreciating those assets -- did we begin in the -- late in the fourth quarter. So it wasn't even the full fourth quarter last year. But that data center will be open permanently.

**Kirsten Edwards - ThinkEquity Partners - Analyst**

Along the same vein, for the sales and promotional, you mentioned that the enrollment counselors' wages were higher year over year. Is that something that should continue same time going forward?

**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

There's two things. First of all, there was an adjustment in the enrollment adviser compensation during the first quarter of this year, where we increased pay levels, so obviously that will continue, as well as additional hiring that we'll be doing in that area.

**Brian Mueller - Apollo Group, Inc. - President**

Yes, so we said in the last number of weeks we will be watching lead flow carefully and matching up our enrollment counselor hiring with where we see the strongest lead flows. And we expect them to be in the Northeast, the Southeast and the Midwest. But it will be done in relationship to that lead flow, so I don't think you can expect as a percent revenue it to increase significantly.

**Operator**

Howard Block, Banc of America Securities.

**Howard Block - Banc of America Securities - Analyst**

Brian, I wanted to get back to Kelly's question quickly. When you say that the selling and promotion will be close to historical levels, does that mean the growth rate will be at historical levels, the margin will be at historical levels?

**Brian Mueller - Apollo Group, Inc. - President**

The spend as a percent of revenue will be at historical levels.

**Howard Block - Banc of America Securities - Analyst**

Historical being some sort of an average margin from 1994 to 2004 or 2000 to 2004?

**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

We're not going to give guidance in that detail. I would say that the last couple of years, selling and promotional has been around 21.5% of revenue in total. And we have been under that in the last four quarters.

**Brian Mueller - Apollo Group, Inc. - President**

So if you averaged the last two years, you would be pretty close.

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

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**Howard Block - Banc of America Securities - Analyst**

Are you actually going to manage it that way? Because it would seem as though you're suggesting there has been a period of say deficit spending. Or there has been a deficit, I would say, in the selling and promotion in the last three quarters. Are you feeling that you have to compensate first before you get to that new run rate?

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**Brian Mueller - Apollo Group, Inc. - President**

Yes, we want to make sure that the investments we're making are in the right places and are getting the returns that we want. But we're not far off from understanding that, and so we will be moving there quickly.

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**Howard Block - Banc of America Securities - Analyst**

On a sequential basis, the enrollment for Axia appears as though it only grew a few hundred students, after several thousand in the prior quarter sequentially. Can you elaborate on that?

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**Brian Mueller - Apollo Group, Inc. - President**

I would say that that is the place where we have had the shortfall with regards to student growth. It is the area of biggest opportunity for us, and when we don't spend where we should spend from an advertising standpoint, that is the biggest percentage of the leads that we don't get, and therefore the number of starts that we get is mostly impacted in that area.

If you're asking is it the result of have we had significant numbers of students either graduating, dropping or transferring into University of Phoenix, none of those three things have happened. The retention rates of those students are up, as compared to students we have put into our UOP program. And we have not yet started graduating them and sending them to UOP in big numbers, but we expect to have a large sample size in quarter four.

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**Howard Block - Banc of America Securities - Analyst**

So the lower spending in the past three or four quarters in selling and promotion -- it seems to suddenly have manifested in Axia in this quarter's enrollment, whereas the prior quarter it grew pretty handsomely on a sequential basis. Even with lower spending in the --

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

On a sequential basis, but the prior quarter also had one of our heavier enrollment periods in it in August, September. Plus you didn't have the -- we had just started it the year-ago September, where we really started to get some traction last February quarter.

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**Brian Mueller - Apollo Group, Inc. - President**

Yes, and you have to understand that the second quarter historically is a quarter where we don't do as well from a new sales standpoint, because of the holiday seasons and the significant amount of time that we're off, and the inability to get advertising placement compared to, for example, the third quarter.

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**Howard Block - Banc of America Securities - Analyst**

If you're going to reward -- you're going to elaborate you said, I guess maybe at your analyst day -- but if you're going to reward your enrollment advisers for "retention success," is it possible we could see them began to focus more on quality rather than quantity?

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

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**Brian Mueller - Apollo Group, Inc. - President**

The comment I made is that we are considering rewarding our academic counselors -- those people that are currently responsible for retention -- rewarding them, putting in place for them a performance matrix and a compensation plan that looks like the enrollment counselors' compensation plan, but for retention. We have noticed that there is significant differences in the performance rate of our academic counselors with regards to their ability to retain students, coach students, keep them in the program, and there is a lot of potential there. There's a lot of money to be made there. If we can apply the same things that we have learned to manage enrollment counselors around it, we can manage academic counselors that same way. We think we can get some good gains. It is really the academic counselors that we'll have more a focus on than the enrollment counselors.

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**Operator**

Gary Bisbee, Lehman Brothers.

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**Gary Bisbee - Lehman Brothers - Analyst**

It looks like given the fairly strong online growth, you can back into the fact that campus enrollments actually fell a couple of percent. First of all, is that right? And second of all, can you give us some sense as to what is going on there, if it is across the board or if there's weakness in a certain geography? Or any color would be helpful.

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**Brian Mueller - Apollo Group, Inc. - President**

Number one, the 20% growth rate or slightly above that at online is not as good as what we wanted, and so I'm not saying that I am satisfied with that. We had put the very top people that we have in that campus on the road. They have been on the road for over two months, really two and a half months, training and preparing all of our ground campus infrastructure to be able to sell and service the online product. So that has negatively impacted our growth rate in the second quarter at online to some extent.

With regards to ground campus growth, yes, it is a couple of percentage points down, but -- and we want to be giving you more information about that as we move forward. It is not going to the something that you want to pay a lot of attention to, in my opinion, in the future. Once we've got all 3,800 or so enrollment counselors throughout the Company able to put a student into the online program, if that is where they want to go, then that is where we will put them. The student will stay at the campus from the standpoint of a student count perspective and from a revenue perspective. And we will allocate out expenses appropriately so that the incentive of the local campus to keep growing in their local marketplace is there.

But actually saying, here is the enrollment growth at online and this is the enrollment growth on the ground, those numbers won't be as significant as they were in the past. What we're focusing on as a company is our capabilities of increasing or growing University of Phoenix students by marketplace, regardless of whether they choose to go on ground or online.

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**Gary Bisbee - Lehman Brothers - Analyst**

Does that at some point for you -- it seems like you have had a natural move where a lot of students realize that they prefer online, given the convenience. Does that at some point mean that you're going to have to shrink the actual campus footprint, or when leases come due, take on less space? I don't know if at some point there's a margin pressure, if we continue to see falling campus-based enrollments when you (multiple speakers) that cost?

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**Brian Mueller - Apollo Group, Inc. - President**

Well, no, actually from a margin standpoint, that is a very good development. Because, number one, online is our largest-margin campus, so putting more students in there is positive. Secondly, yes, it would enable us to over time -- especially in areas like California, where space is very expensive -- cut back on the total amount of space that is necessary. That is going to help the margin as well.

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

But we will absolutely be investing in space, not to the same extent, but we will still be investing in space because we will start to utilize it in slightly different ways -- the computer labs, tutor centers, customer service support areas. We will be having classrooms. We will offer our core programs that we can build class size in there. Students will still be attending on ground in those programs. So there will be classrooms but there will also be additional administrative space that we will put in place to offer services to students that currently we don't offer. So the movement of students into the online program in a higher percentage is a positive thing, not a negative thing, both on the top and bottom line.

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**Gary Bisbee - Lehman Brothers - Analyst**

You said you're going to start in a month and a half advertising separately for Axia. I assume that is going to be advertising for a two-year program. Do you think that you'll get nearly as many as you're expecting to stay around, and then continue on with University of Phoenix when you're getting them in the front door with the advertising message of two-year program, instead of coming through UOP leads who wanted a four-year program. And in the case that not nearly as many of them stay around for the third and fourth year, how do you think about the investment in that student? It would seem like the return on investment would be a fair amount lower if you've got to spend a similar amount upfront on advertising, but yet you get two years of a lower revenue and lower profit from that student. I guess I just want to understand your thinking as it relates to that.

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**Brian Mueller - Apollo Group, Inc. - President**

We don't expect that to happen at all, because we're going to make sure as we brand active college and the message that goes out there, it is a higher ed program. It is not a vocational program. It is not a technical program. It is not a career education program. It is not something that would involve us developing placement opportunities for students. So we're not going to advertise it, brand it or promote it from that standpoint. What we're going to say is, it is a program designed for students who want eventually to get a Baccalaureate Degree. But it is going to be a very nice way to transition into higher education for students who can't or don't want to commit to a state university for four years, a private four-year college for four years, move away from home and do all those kind of things.

It is going to be promoted for students who have a part-time job. They want to turn it into a full-time job. They want to stay in their local community. They want to stay at home. And this is a great way to be able to go to school in a way that is affordable, because Title IV costs will cover it, but also in a way that there is a very, very foreseeable goal that is in place, as compared to what many working students who attend a community college have to see, which is five, six, or seven years. We're talking about 20 months and it's completely online, and it can be used as a way then to transition into a Baccalaureate Degree. So we don't expect that to happen. It is not vocational. It is not technical. It is not career ed.

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**Operator**

Mark Marostica, Piper Jaffray.

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**Mark Marostica - Piper Jaffray - Analyst**

My first question is with regards to selling and promotion yet again. You mentioned, I think, Brian, that you -- and correct me if I'm wrong on this -- that during the February quarter, toward the end of it perhaps, you actually increased selling and promotion spend. I thought you had mentioned you saw some positive impact. Could you give us a little more definition of what you saw once you turned the spigot on?

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**Brian Mueller - Apollo Group, Inc. - President**

One of the things when we had two separate marketing departments -- that was a liability for us -- was that each department and each site of the University was really held to specific goals. We had to be -- so there was a conservative approach taken with regards to zip code areas, that the ground side of our business would give to vendors in order to generate leads. In order to get the best return, they were keeping those zip code areas fairly confined, knowing that as you get a student closer to the local campus, your opportunity to start that student, to convert that lead is higher.

As we trained enrollment counselors to sell both the online and on ground product, we got less restrictive about that. And we started to expand those zip code areas and started to send to enrollment counselors leads that were further away from the local campus, knowing that we would have the online product to offer them.

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

That helped two ways. Number one, as you expand the zip code areas, you can pay less per lead, and obviously also you can expand the number of leads you get, which that is where we have seen the greatest increase right now, especially in the newer areas of the country where we haven't been for a long period of time -- the Southeast, the Midwest and the Northeast.

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**Mark Marostica - Piper Jaffray - Analyst**

Perhaps it is a little early to ask this question, but in regards to these leads that you talked about for these other sources, other locations, with the expanded zip code strategy, what type of conversion rates have you seen on those leads?

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**Brian Mueller - Apollo Group, Inc. - President**

We typically don't release conversion rates. But the conversion rates, as we are able to evaluate it at this point, are holding their own. Where we have trouble, more difficulty with conversion rates -- generating of leads and converting rates is in marketplaces where we have been the longest, specifically California. And that is why we think that rolling out Axia College in the California markets will be helpful. I think it will help us generate more leads, but I think it will help us significantly increase the conversion rates, because a high percentage of their leads are level one leads.

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**Mark Marostica - Piper Jaffray - Analyst**

That color is helpful. On to bad debt expense, one of the things I was interested in learning is what you're doing to actually turn the trend of bad debt expense that has been at elevated levels as of late around. I think you mentioned by fourth quarter perhaps early next year we should expect that to turn, but any commentary around what you're doing to turn that would be helpful.

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

Basically, when you look at it, the bad debt expense came from predominately one thing. And that was the fact that as we rolled out Axia 18 months ago, we were rolling it out very, very rapidly, and we frankly did not follow our normal process as far as got a little bit behind, if you will, having students apply for financial aid prior to beginning their first night of class, so that we knew that the financial aid money was going to come in. That situation was not wholly rectified until late last summer. It has been, but we do take our bad debt reserves based on an aging of the receivable, which is why we anticipate that it will run through into the fourth quarter before we finally get that back under control. But it was a very specific event that caused that.

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**Brian Mueller - Apollo Group, Inc. - President**

And as you look back on that, had we made the decision to put Axia College under the University of Phoenix to begin with, we could have avoided that issue. Putting that entire organization together in a short period of time in order to get at that marketplace through Western International University caused us to get, from an administrative standpoint, a little bit behind with regards to processing financial aid stuff with those new students. I think the good news is that is a completely fixable problem. It is not the result of huge percentages of Axia College students dropping, as compared to students at other levels.

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**Mark Marostica - Piper Jaffray - Analyst**

One last wrap-up question. Could you review for us how many new campus openings you did in the first half of '06, and then what your plan is in the second half and perhaps '07 as well?

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

Our guidance is still intact at seven to nine new campuses. We opened three new campuses in the first quarter of fiscal '06. We opened no campuses during the second quarter. Our anticipation is that we will open Northwest Indiana, Omaha and Harrisburg in the third quarter --

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

Harrisburg, Pennsylvania. Madison, Wisconsin is scheduled for late in the third, early in the fourth, and then Connecticut is in the fourth quarter. I think I might have missed one. Columbia, South Carolina should be in the third quarter as well.

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**Operator**

Jeff Silber, Harris Nesbitt.

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**Jeff Silber - Harris Nesbitt - Analyst**

Just a follow-up to that -- it looks like you opened up about six learning centers. Is that something we're going to see going forward, more learning centers than full campuses?

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**Brian Mueller - Apollo Group, Inc. - President**

I don't know that that will be different than what we have done in the past, although we will be opening up some of those learning centers as online-only campuses, which means we'll put a sales staff up there and some support service, but we won't open a full-blown campus. We will have a physical presence in the community and we will be able to sell in that local community, but we won't have to make the investment of a huge classroom infrastructure and lots of administrative staff before we see significant revenues. And so we think that the time to profitability in those learning centers will be quicker than it has been in the past.

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**Jeff Silber - Harris Nesbitt - Analyst**

How about an update on your potential entrance into the New York market?

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

We still have our application in there. I know that they do have that moratorium. I'm not exactly clear on how that is impacting our application, although our application has been there for eight years. So that is effectively a moratorium, isn't it?

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**Jeff Silber - Harris Nesbitt - Analyst**

I guess so. Just one follow-up. Can you give us an update on the turnover of your enrollment counselors?

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**Brian Mueller - Apollo Group, Inc. - President**

It was down significantly in that first quarter, and we are maintaining that level in the second quarter. Part of that is because of a new compensation plan. Part of that is because we're rolling out online and giving ground campus enrollment counselors a greater chance to be successful. We think thirdly, the implementation of the qualifying center, where counselors don't have to work through hundreds of leads in order to get at students who are very interested improves the quality of their job. So we expect that downward trend in turnover to continue.

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**Operator**

Sara Gubins, Merrill Lynch.

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**Sara Gubins - Merrill Lynch - Analyst**

First, can you talk a bit about how long you would expect improving lead flow to translate into better enrollment trends, how long that takes to cycle through the system, particularly for University of Phoenix, given that it looks like UOP enrollments were down year over year in the quarter.

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

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**Brian Mueller - Apollo Group, Inc. - President**

It is a 60 to 90-day cycle. So the investments that we're making now, I believe you'll start to see towards the end of the third quarter, and into the fourth quarter. That is where we will, I think, start to gain some momentum, especially if we hold with our spend throughout the third quarter.

The increase in leads is something that you'll see through the third quarter, but then as we move into the fourth quarter and get good at right-pricing leads, you might see an actual decline in the number of leads, an increase in the cost per lead, but also an increase in the conversion rate. And as I said earlier, the goal of the advertising.com strategy is to move towards lowering cost per acquisition. We'll continue to keep you updated on that.

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**Sara Gubins - Merrill Lynch - Analyst**

So is it fair to say that from an enrollment perspective, things are going to get worse in terms of growth before they get better?

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**Brian Mueller - Apollo Group, Inc. - President**

No.

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

But we're not going to guide to that right now.

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**Sara Gubins - Merrill Lynch - Analyst**

Ok, can you also talk a bit about revenue per student trends, and the impact that Axia may be having on this, and what you're expecting in general in terms of revenue per student trends over the next couple of quarters?

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

Revenue per student has actually gone down, as you recognize, with a mix shift toward the Axia students, since it is a lower-priced program than the University of Phoenix program for the Baccalaureate Degree and the Master's Degrees. So we would anticipate that the revenue per student trends will continue to be flat to slightly negative over the next several quarters, with starting to see some improvement in those numbers as again we graduate students from Axia into the University of Phoenix.

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**Sara Gubins - Merrill Lynch - Analyst**

When you mention rolling out Axia to the California market, do you mean physically rolling out meaning having it in your on-ground campuses?

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**Brian Mueller - Apollo Group, Inc. - President**

No, not initially. It is going to be promoted and sold as a completely online program, which we think is the right thing to do given the characteristics of those students. When I meant is that we are training all the enrollment counselors around the product, so that if a level one student becomes a lead at one of those campuses, they are able to offer them the opportunity to go into Axia College in an online environment, and then they would count the student there and recognize the revenue there and all of that.

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**Operator**

Corey Greendale, First Analysis.

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

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**Corey Greendale - First Analysis - Analyst**

First question for Brian. Could you just give us a little bit of insight on the extent to which the local campuses have autonomy over their S&P spend, if they can control their own hiring of admissions reps to ramping that up, selling their own advertising, how they spend that or how much that is determined centrally?

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**Brian Mueller - Apollo Group, Inc. - President**

In terms of the enrollment counselors, yes, that is their responsibility. They just need to make sure that they are doing it in line with lead flow and with anticipated lead flow. So there's a lot of communication there. But we are getting better at understanding that, and so as we move forward, we think we will get better at making sure that the number of enrollment counselors in a marketplace is very specific to what we're capable of from a lead generation standpoint, and therefore make the whole process more efficient.

On the advertising side, right now, the majority of our spend is on the Internet. And we have moved in that direction. We moved in that direction at the online campus many years ago, became very much a leader and very successful from that standpoint. The ground campuses took on that strategy, and we have now become very Internet-focused from the standpoint of our advertising strategy. If we can start to experience some success from the standpoint of right-pricing leads, increasing conversion rates, increasing retention rates, and we start to get some traction here, in the third and especially the fourth quarter, I think what you'll find is that we will move back into a period of time where we are going to do more brand advertising. We're going to provide more air support in an effort to increase the efficiency of our Internet spend. But we're not going to do that in the next number of months, because we've got to focus on getting the enrollment trend back up.

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**Corey Greendale - First Analysis - Analyst**

Is that to say that the spend is being more controlled at the local level than at the headquarters level right now?

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**Brian Mueller - Apollo Group, Inc. - President**

No, right now it is more controlled at the headquarters level. The majority of it is controlled there because we make the Internet buys centrally. It is a lot more efficient way to do it. But as we move forward, if we can start to get some traction from an enrollment standpoint, we will turn some of that back over to the campuses to use local strategies from an air support standpoint that we think will be helpful.

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**Corey Greendale - First Analysis - Analyst**

I understand. And just a quick follow-up, something that hasn't been brought up for a while. But I was just wondering, as you're looking to grow your traction in the younger, not degree completion market, if domestic acquisitions are any higher on the priority list than they might have been in the past?

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**Brian Mueller - Apollo Group, Inc. - President**

No, I wouldn't say that that has gone up higher from a priority standpoint. They are things that we watch and we evaluate things on a continuous basis, but I wouldn't say it has moved up from a priority standpoint.

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

That evaluation and the way we do that hasn't changed at all.

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**Corey Greendale - First Analysis - Analyst**

So nothing you would say is imminent?

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

No.

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**Operator**

Jennifer Childe, Bear Stearns.

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**Jennifer Childe - Bear Stearns - Analyst**

Brian, has the 60 to 90-day sales cycle changed at all? Has it always been 60 to 90 days? And Axia students versus University of Phoenix students -- are they right in the middle of that, at the low end?

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**Brian Mueller - Apollo Group, Inc. - President**

We haven't seen any difference in the time it takes to recruit an Axia student versus a UOP student. But remember, until we start being more aggressive about advertising specifically to an 18 to 24-year-old marketplace, that is probably to be expected. Right now, the students that are in Axia College are students who investigated initially about University of Phoenix. We put them there because we thought we had a better chance to retain them, which is true.

We're not sure exactly what is going to happen when we start to advertise more aggressively to 18 to 24-year-old students in terms of the time it takes to get them into the program. It is one of those things that is a little bit of an unknown now, and as we learn, we will make whatever adjustments we need to.

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**Jennifer Childe - Bear Stearns - Analyst**

Are you seeing any diminishing returns from increased marketing spending relative to previous years because of increased competition?

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**Brian Mueller - Apollo Group, Inc. - President**

No, and that is the encouraging thing. We've only got a couple of months under our belt really, being a little bit more aggressive from an advertising standpoint, but we haven't seen any initial results that would say to us we can't get the return that we expect. And very honestly, the whole deal with the contract with advertising.com and that strategy is a strategy that we want to put ourselves in a position to get the lion's share or a much larger percentage of the best leads that exist out there in the marketplace on a monthly basis. If we spent randomly and without strategy, I think maybe what you are saying -- that would be a risk, but I don't think that we are doing that.

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**Operator**

Chris Gutek, Morgan Stanley.

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**Chris Gutek - Morgan Stanley - Analyst**

Kenda, I guess I'm a little bit confused on your comment earlier about the seasonality regarding enrollments. If I look back over the last several years, the Company has always had sequential growth in enrollments, and in fact, the highest sequential growth --

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

Chris, what I think I was referring to was just comparing the Axia, but as far as not the sequential growth, that was the slowing at online.

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

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**Chris Gutek - Morgan Stanley - Analyst**

But the last three years, the highest sequential growth has always come in the fiscal second quarter, and here we have actually seen a sequential decline in the fiscal second quarter. So maybe could you just talk about the seasonality? Obviously, your business model is less seasonal versus some competitors, but historically the second quarter has been seasonally strong, not seasonally weak.

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**Brian Mueller - Apollo Group, Inc. - President**

Seasonally, we have always reached an apex in the months of March and October. And so from a --

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

Right. Which wouldn't be in the second quarter.

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**Brian Mueller - Apollo Group, Inc. - President**

So from a total enrollment standpoint, and from a revenue standpoint, March and October have always been our strongest months, and then we have gone into decline as we move towards the summer and move towards the holiday season.

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

But I think that also -- and this is something that is important -- University of Phoenix Online has the same seasonal trends and has had the same seasonal trends as University of Phoenix, but it was growing so rapidly that that was masking those trends just because of the sheer volume. The trends were still there, but they weren't as apparent because of the sheer volume and the growth and the acceptance of online education through that period.

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**Chris Gutek - Morgan Stanley - Analyst**

Right. Okay. Just to be clear, though, the sequential growth has always been highest in the fiscal second quarter, so I will just toss that out there.

But secondly, I guess if you look at the significant deceleration in sequential growth we have seen in the last couple of quarters, given the multi-year duration of these average educational programs, it wouldn't seem to be explained by a drop-off in marketing spending over the last couple of months. It would seem to also indicate a significant -- a potential, also a significant increase in attrition of students. Am I missing something there, or is it really just a sharp drop-off in new starts?

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**Brian Mueller - Apollo Group, Inc. - President**

No, it is really a sharp drop-off, a fairly sharp drop-off in spending, in advertising at the end of the quarter, for really about five quarters in a row. And the accumulated effect of that has caused us to reach what we think is our low point in this quarter.

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**Chris Gutek - Morgan Stanley - Analyst**

A couple of quick follow-ups. Brian, you mentioned before you thought the operating margins longer-term could hold at relatively near historical levels. What is the thinking at the gross margin? Obviously, the gross margin has been declining. Is that expected to continue, or do you think that will stabilize soon?

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

The gross margin is declining because of the bad debt. I think we have already made our comments on that.

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**Chris Gutek - Morgan Stanley - Analyst**

Fair enough. Finally, real quick, it says the severance cost for Todd Nelson were a bit less than you had previously told us to expect, and it sounds like some of that flowed directly to shareholders' equity.

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

Right, exactly.

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**Chris Gutek - Morgan Stanley - Analyst**

Why did that happen?

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

Why did that happen? Because of the accounting for stock options under FAS 123(R).

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**Operator**

Trey Cowan, Sanford Group.

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**Trey Cowan - Sanford Group - Analyst**

Thanks for taking my call. I guess I'm a little dense here, but maybe you all can help me out. Whenever you look at the advertising.com strategy, how has that relationship changed versus what you were previously doing with advertising.com?

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**Brian Mueller - Apollo Group, Inc. - President**

Previously, advertising.com was one of our vendors. And it was one of 40 principal vendors, and then there were thousands of affiliates under those 40, what we refer to as main partners. The relationship that we have with them now is that they're an exclusive partner of ours in the EDU space, which means they are not doing business with any other EDU vendor. It means that all of our major partners and all of their affiliates, in order to do business with us in the future, have to put their leads through advertising.com's technology, which makes then everything that they know about those leads transparent to ad.com and to us.

In the past, those partners and the affiliates had all of the information. So as we would negotiate lead costs, and as we would negotiate lead amounts, we were doing it with very much a deficit of information, which made the whole process very inefficient on our end, and made the process very manipulative on their end. Once all of the information -- and we believe everybody will still want to do business with us, because we have a large spend out there -- once all those leads go through ad.com's technology, so we know where the lead originated, at what time of day or night, what the creative was, what the responsiveness, the click-through rates and the conversion rates are on that property or with that keyword. At that point, we can begin working with vendors to right-price leads. And so, for a good vendor who has good properties, with good messages, with good landing pages, with good conversion rates, we will actually increase our cost per lead with them and try to garner all the leads from that particular site, not just maybe 25 percent of it.

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**Trey Cowan - Sanford Group - Analyst**

If I'm looking backwards, can you help me through what the strategy was, as far as not spending as much in the third month of the quarter in the last few quarters on your selling and promotion?

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

**Brian Mueller - Apollo Group, Inc. - President**

Protecting the bottom line.

**Trey Cowan - Sanford Group - Analyst**

If you're looking out into the future, I believe you're going to replace your open text system, as far as your imaging that you do, as far as managing your student files and whatnot. Can you tell me what the timeframe on that is, and what you expect to accomplish by changing out that system?

**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

I don't even know about that.

**Brian Mueller - Apollo Group, Inc. - President**

There are discussions around that. I don't have the details around that.

**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

I don't think anything has been finalized there.

**Operator**

Bob Craig, Stifel Nicolaus.

**Bob Craig - Stifel Nicolaus - Analyst**

A couple of questions for you. If you said this and I missed it, I apologize. Have you received all requisite regulatory approvals to fold Axia into UOP?

**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

Actually, I believe that the State of Arizona is meeting today on the final one.

**Bob Craig - Stifel Nicolaus - Analyst**

But that is it? Everything else is all set?

**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

I believe so, yes.

**Bob Craig - Stifel Nicolaus - Analyst**

When you ramp up spending in May, on the 18 to 24-year-old market, you are going to do so under the name Axia College, as opposed to just alternately layer in an Associates Degrees under the University of Phoenix and maximize the University of Phoenix brand name, is that correct?

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

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**Brian Mueller - Apollo Group, Inc. - President**

We will be promoting it as Axia College of the University of Phoenix. And so University of Phoenix, that name will definitely be attached to Axia College, but we do have separate promotional material. We have a separate website that we will be moving those students to that we think they will better relate to.

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**Bob Craig - Stifel Nicolaus - Analyst**

So the current plan is to indefinitely use and build the Axia brand name?

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**Brian Mueller - Apollo Group, Inc. - President**

Yes. We want to build the Axia brand name as part of the University of Phoenix. Yes.

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**Bob Craig - Stifel Nicolaus - Analyst**

Will there be any upcoming transitional period when you will essentially hold off enrolling or starting students into Axia under the Western umbrella, versus the University of Phoenix umbrella? Will that in any way be part and parcel of hindering revenue growth in the third quarter?

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**Brian Mueller - Apollo Group, Inc. - President**

No.

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**Bob Craig - Stifel Nicolaus - Analyst**

One last question for you. As far as the enrollment adviser compensation expense increase, the 21% year to year, can you give any indication of the breakdown essentially between wage growth versus recruiter growth? I take it the majority would be wages as opposed to recruiters, but --

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**Brian Mueller - Apollo Group, Inc. - President**

It is. It is wages, as opposed -- wages of recruiters as opposed to advertising. Is that what you meant?

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**Bob Craig - Stifel Nicolaus - Analyst**

Yes, exactly. Volume versus price, in other words.

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**Brian Mueller - Apollo Group, Inc. - President**

Now I'm confused -- I'm sorry.

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**Bob Craig - Stifel Nicolaus - Analyst**

Well, number of additional enrollment advisers versus the wage growth and the compensation plan changes.

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**Brian Mueller - Apollo Group, Inc. - President**

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

Thank you. It is a combination of those. I don't have the exact breakout of that, but it is a combination. We're definitely hiring more people in areas where we believe we have a lot of strength from a lead growth standpoint. But a certain percentage also relates to the fact that we are, on average, paying enrollment counselors more than we did a year ago.

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**Bob Craig - Stifel Nicolaus - Analyst**

A did think of one last one. Have there been any other significant management changes and/or are there any open positions that you're currently looking to fill?

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

The only significant management change was that we brought the IT departments together. We had a lot of duplication. Bob Carroll has left our organization, and Joe Mildenhall has assumed the role of Vice President of Information Technology.

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**Operator**

Greg Cappelli, Credit Suisse.

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**Greg Cappelli - Credit Suisse - Analyst**

Hi Brian and Kenda, two quick ones. Just thinking back about your comments, Brian, about the quarter and then the holiday issue, wondering if you can give us a little bit more color how much of the weak enrollments this quarter were due to attritions of students who didn't come back after December versus the weak new starts due to the advertising issues? I guess originally, you guys had had a goal for you suspended guidance of around 15%. When I look at the shortfall versus that, give us some idea of how much of that is attrition versus new student related?

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**Brian Mueller - Apollo Group, Inc. - President**

A higher percentage of it would be as a result of new sales versus the attrition. Most of the attrition that happened was a onetime event in December. I don't know exactly at this point what percentage of those students we didn't get back at all, because we're still trying to get some of them back. But we've got the vast majority of them returned in January and February. So a little bit of the student shortfall has to do with that, but the biggest majority has to do with the lack of advertising leads and therefore new starts.

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**Greg Cappelli - Credit Suisse - Analyst**

That's helpful. In terms of Axia and campuses, have you given any thought to just accelerating the rollout there across the country, in terms of getting Axia in sooner, and if not, why not?

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**Brian Mueller - Apollo Group, Inc. - President**

Yes, we are. Yes, we have. We moved much more aggressively in California, where we think we have the biggest opportunity. Initially, I said we were thinking about starting specific Axia advertising in the fourth quarter, in June or July, in preparation for August, but we have moved that up to May. You can expect that we will get -- now that we have the whole online part of it done, we will get more aggressive at expanding that Axia College program throughout the country.

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**Greg Cappelli - Credit Suisse - Analyst**

Just one more quick one. When I think about August, you guys have sort of pointed to that being an important period or quarter, for you having a better understanding of the continuation rate of students from Axia to UOP. Are we looking at a number north of 10,000 to 15,000 students that you'll have in your database able to use to do an analysis on that by the fourth quarter?

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

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**Brian Mueller - Apollo Group, Inc. - President**

No, it won't be north of 10,000. It will be probably -- I can't tell you, but it won't be at 10,000 or north of it. It will be under that.

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**Greg Cappelli - Credit Suisse - Analyst**

That's helpful. Brian, have you -- is there any change in your thinking on share repurchases?

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

We have a Board meeting tomorrow, and we will be discussing that with the Board.

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**Operator**

Howard Block, Banc of America Securities.

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**Howard Block - Banc of America Securities - Analyst**

The question is, Brian, what is hard to sort of reconcile is, I guess, your large and growing appetite for leads with your expectation of being able to right-price them. What gives you any confidence that you're going to be able to "right-price" while you're asking for more? Years ago, when you were building online successfully, you were virtually a monopsony, and now that is no longer the case. I'm just wondering where you're going to get that leverage from?

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**Brian Mueller - Apollo Group, Inc. - President**

That is a good question. It is a big reason why we did this. You can read lots of reports out there that they -- typically, people are expecting Internet advertising space to go up between 10 and 15% next year. For a smaller player, that is a significant problem. For a larger player, that has an exclusive relationship with the largest Internet network in the world, and their ability to buy property out 12 to 18 months, that puts us in an advantageous position. The fact that 20% of their business only or less is in the EDU space allows them again to buy space out far in advance, as much as 12 to 18 months. And if we find that there are properties that are not good from an EDU standpoint, they are able to sell that to the other people that they do business with in different industries. So that was a big part of why we think that relationship puts us -- number one, we've got the technology and so we can do all of the intelligence on the leads and have all that intelligence, but then secondly, it gives us an advantage from a standpoint of buying advertising space.

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**Howard Block - Banc of America Securities - Analyst**

Then I would guess if there is a little bit of limitation on the inventory, and you're getting a more exclusive bond, this is bad news for the other buyers?

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**Brian Mueller - Apollo Group, Inc. - President**

I hope so.

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**Howard Block - Banc of America Securities - Analyst**

Again, on the Web analytics piece that you're excited about with advertising, isn't it arguable that what their Web analytics is really going to do is just rather than improve the quality of the leads, which they are not necessarily generating exclusively, it is just going to increase the information on the bad leads?

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**Brian Mueller - Apollo Group, Inc. - President**

It helps tremendously from a couple of standpoints. Number one, once you find out where the good leads come from, you're going to get some sense for how many good leads are available there. And if we want to temporarily increase the amount we're willing to pay for those good leads to keep them out of the hands of our competition, we will actually be willing to do that. That is part of the strategy. That puts us in an advantageous position.

But then secondly, there are lots of leads out there, referred to as co-reg leads, which aren't the greatest leads and make the enrollment counselor's job very inefficient. However, we will have one of the country's largest qualifying centers. And because we're running all those leads through that qualifying center, we will only be sending to enrollment counselors leads that we can hot transfer, which means we've gotten voice-to-voice contact with them. Does that mean we could go out there and purchase 100,000 co-reg leads in a month, and pay \$5 for them? It does, because we'll run them through the qualifying center, and we will only transfer them to an enrollment counselor if we make voice-to-voice contact, and we know then that we've got a lead that might convert at 15 to 20%.

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**Operator**

Kelly Flynn, UBS.

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**Kelly Flynn - UBS - Analyst**

Back to the margin issue. On Axia, can you talk about ex the bad debt issue, maybe if you look out a year or so, where does the Axia gross margin shake out relative to the UOP gross margin? Where does the operating margin shake out relatively as well? Maybe give a little detail on bad debt on a normalized basis for Axia students relative to UOP. It would seem, given maybe the income profile of the students on average, that it might be a little bit higher.

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

Let me take that part of it, the last part first. That is the income profile of those students. The way the Axia program is priced, I think as Brian mentioned earlier, allows the Title IV funding to cover 100% of that tuition. So frankly, we're not lending to the students directly. So the income profile of those students really has no impact on our bad debt from that perspective.

As far as going out with what a normalized level would be, I would anticipate that we would return to close to historical University of Phoenix levels, with the bad debt at Axia and at University of Phoenix, so that those really wouldn't see a difference. Remember, Axia is the Associates program. I don't really break out Baccalaureate program and Master's program and Doctoral program in that same manner. From our perspective, we can think that is where it will go.

As far as the margin question, that is really where it becomes a little bit tougher, because if the students -- we'll know in the fourth quarter how the students are going to behave, but assuming the students move on into the University of Phoenix Baccalaureate program, we're not going to have to pay to recruit that student to continue the program.

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**Brian Mueller - Apollo Group, Inc. - President**

Let me also say that if you look at it just from the standpoint of the operational margin and the University of Phoenix online, and I think I said this last conference call, but we have done a number of studies. There is no question that revenue per student per week goes down because of the lower tuition rate, but if you take groups of students that started under the UOP model and those tuition rates, and Axia College students under that model, the revenue per student per year is actually greater under the Axia model, because the retention rate is higher.

So if you look, for example, because we have had Axia College at the University of Phoenix Online now since '04 of September, if you look at the operating margin of University of Phoenix Online, even though a huge percentage of those students are now in Axia College, we haven't -- there hasn't been a degradation of that operating margin at the campus.

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**Kelly Flynn - UBS - Analyst**

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

So what is the answer on the gross margin? Do you think it is going to be comparable, and therefore that is why the operating margin is? It sounds like that is what you're saying.

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**Brian Mueller - Apollo Group, Inc. - President**

I think yes. I think a big part of it has to do is what we eventually find out about the percentage of students that transfer into the University of Phoenix.

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**Kelly Flynn - UBS - Analyst**

Ok, fair enough, thank you.

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**Operator**

Mark Hughes, SunTrust.

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**Mark Hughes - SunTrust - Analyst**

Could you give us a sense of what the absolute level of lead flow was year-over-year in the quarter? Obviously, your advertising costs were down a bit, but can you say anything about lead flow itself?

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**Brian Mueller - Apollo Group, Inc. - President**

We haven't historically given that information in terms of lead flow, but we have made some gains on a cost per lead basis, and so what you could ascertain from that is that the cost -- we spent less, but it didn't all go to a direct level -- the same percentage of fewer leads. So there was a reduction in leads, but not commensurate with the amount of money that we spent.

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**Mark Hughes - SunTrust - Analyst**

Could you talk about the productivity of the enrollment counselors? You suggested the volume of counselors up year over year. How was their productivity in the quarter, if the lead volume was down but they were up? Could you talk about that dynamic?

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**Brian Mueller - Apollo Group, Inc. - President**

There wasn't a depreciation of their productivity, but there wasn't an acceleration of their productivity, and that is what we're looking for.

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**Mark Hughes - SunTrust - Analyst**

If you bump up the lead volume, but there is not an acceleration of productivity, is that going to lead to an acceleration in enrollment?

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**Brian Mueller - Apollo Group, Inc. - President**

Yes. If we bump up the spend and we don't get the commensurate return, then yes, that is not going to be a good sign. But early indications are that that is not going to happen.

But yes, you're right. There is a limit ultimately to where this thing can go. I don't have any idea as we sit here today what that limit is, but we haven't seen, at this point in time, a negative response to that increased spend. Very honestly, at some point, if we're successful in right-pricing

Mar. 23. 2006 / 11:00AM ET, APOL - Q2 2006 Apollo Group Earnings Conference Call

leads, some of that increase in spend and therefore the increase in productivity that we hope to see is going to be at the expense of some of our competition.

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**Mark Hughes - SunTrust - Analyst**

Presumably the enrollment counselors, there wasn't any idle time during the quarter. They were all busy and as productive as possible. Would that be fair to say?

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**Brian Mueller - Apollo Group, Inc. - President**

Yes.

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**Kenda Gonzales - Apollo Group, Inc. - CFO, Secretary, Treasurer**

Operator, we have time for just one more question. We've already gone about ten minutes over. So whatever the next question in the queue will be our last question today.

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**Operator**

Gary Bisbee, Lehman Brothers.

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**Gary Bisbee - Lehman Brothers - Analyst**

Just one follow-on question. I understand the opportunity to track the different larger addressable market by rolling out the reps at the campuses to sell Axia. But don't you fear to a certain extent that there could be further mix shift issues like you have had in online, where I don't know if you realized after the fact, or somehow it turned out that half the leads coming in the door were a better fit for Axia, and so couldn't we have this continued pressure on your revenues and margins for several quarters more than it would if you didn't sell it aggressively in the campuses?

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**Brian Mueller - Apollo Group, Inc. - President**

That is a good question. You're right in answering that question. But remember that we have already taken the biggest hit, because our online campus is 60% of all of the University of Phoenix now. The online campus has the highest tuition rate. So the differential between that rate and the Axia College rate is the greatest, and that is your biggest risk. All level one, level two students at University of Phoenix online are in Axia College now. So we've taken the biggest hit on that.

As we roll it out now, we will be rolling it out campus by campus, so not all at the same time. And we will be rolling it out to campuses whose tuition rates are closer to the Axia College tuition rates. So the risk is not nearly as great because one, we're rolling it out gradually; and two, the tuition rates are closer, especially in the middle parts of the country.

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**John Sperling - Apollo Group, Inc. - Acting Executive Chairman of the Board**

Thanks a lot everyone. See you next quarter.

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**Operator**

This concludes today's conference call. Thank you for your participation. You may now disconnect.

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