

FINAL TRANSCRIPT

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APEI - Q1 2011 American Public Education Inc Earnings Conference Call

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American Public Education, Inc. - CEO, Pres

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the first-quarter 2011 American Public Education Incorporated earnings conference call. My name is Jonathan and I will be your operator for today. At this time, all participants are in a listen-only mode.

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We will be conducting a question-and-answer session after the prepared remarks. (Operator Instructions). As a reminder, this conference call is being recorded for replay purposes. At this time, I would like to hand the call off to one of your speakers for today, Mr. Chris Symanoskie, Vice President of Investor Relations. You may proceed, sir.

Chris Symanoskie - American Public Education, Inc. - Director of IR

Thank you operator. Good evening, and welcome to American Public Education's first-quarter 2011 earnings conference call. Presentation materials for today's call are available on the webcast section of our investor relations website, and are included as an exhibit to our current report on Form 8-K filed just recently. During the Q&A session, we ask that participants limit their questions to one per caller, to enable broader participation.

Please note that statements made in this conference call regarding American Public Education or its subsidiaries, that are not historical facts are forward-looking statements based on current expectations, assumptions, estimates and projections about American Public Education and the industry. These forward-looking statements are subject to risks and uncertainties that could cause actual future events or results to differ materially from such statements. Forward-looking statements can be identified by words such as anticipate, believe, could, estimate, expect, intend, may, should, will, and would. These forward-looking statements include, without limitation, statements about the second quarter 2011, as well as other statements regarding expected future growth.

Actual results could differ materially from those expressed or implied by these forward-looking statements, as a result of various factors including the risk factors described in the risk factors section, and elsewhere in the Company's annual report on Form 10-K filed with the SEC, the Company's quarterly reports on Form 10-Q filed with the SEC, and the Company's other SEC filings. The Company undertakes no obligation to update publicly any forward-looking statements for any reason, even if new information becomes available or other events occur in the future. This evening, it's my pleasure to introduce Dr. Wallace Boston, our President and CEO and Harry Wilkins, our Executive Vice President and Chief Financial Officer. Now, at this time, I'll turn the call over to Dr. Boston.

Wallace Boston - American Public Education, Inc. - CEO, Pres

Thank you, Chris. Good evening ladies and gentlemen. In today's conference call, I will review the results of our operations for the first quarter of 2011 and discuss how the fundamental principles of our organization lead to positive student outcomes, growing recognition for academic quality, and stronger relationships with the various communities we serve. Then Harry, our Chief Financial Officer, will discuss our first-quarter financial results, the outlook for the second quarter, and provide additional perspective on our long-term strategy.

Moving to slide number three, in the first quarter of 2011, the rate of growth in net course registrations from civilian students accelerated, led by a 97% increase in net course registrations from students using Title IV and a 59% increase in net course registrations from students using Veterans benefits. We believe our success is a result of our growing reputation for quality and affordability, our continued emphasis on civilian outreach, and the effectiveness of our innovative awareness campaigns.

Moving on to slide number four, net course registrations from students using military tuition assistance increased 16% year-over-year, representing a slight acceleration from the previous quarter. We are pleased with the growth of our military population, especially in light of continued deployment and tighter military budgets. Last year, despite high levels of military deployment and transition, we increased our military tuition assistance market share from approximately 12% to 15%, based on our calculations using data provided at the most recent CCME conference.

We are committed to honoring our military heritage, but we acknowledge that increasing the diversity of our learners through civilian outreach is beneficial to learning, to the stability of our operations, and to our future growth. Civilians are the fastest



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growing segment of our student population, and we expect civilians to be the primary top line growth driver going forward, as students not using tuition assistance now represent 53% of total net course registrations.

Moving forward to slide number five, last week, we announced that the Accreditation Council for Business Schools and Programs, ACBSP, has certified both the undergraduate and graduate business programs offered by American Public University and American Military University. ACBSP's accreditation of our business programs further illustrates how our teaching and learning processes meet rigorous educational standards. APUS will soon be issuing a formal press release announcing involvement in a major grant initiative directly related to academic quality and retention. The initiative, organized by a national consortium of post-secondary institutions, will feature predictive modeling of learning outcomes and academic progression at six major online education providers.

Much of the analytics methodology is predicated upon work developed at APUS. Dr. Phil Ice, VP of Research & Development at APUS, will serve as the project's primary investigator. The award follows an April 11th APUS announcement of a related analytics research grant from Next Generation Learning Challenges, an organization jointly designed and funded by the Gates and William and Flora Hewlett Foundations. It is our belief that participation in research projects like this demonstrates our transparency, as well as our desire to share retention findings in studies that include non-profit and proprietary institutions with substantial online student populations. We contribute to academia through scholarly research, sharing best practices, and through participation in the Sakai Open Source Community.

In the first quarter of 2011, our provost was the featured speaker in the higher ed track at the Consumer Electronics Show in Las Vegas, where he shared a panel with the Gates Foundation and the Department of Education. At the Higher Learning Commission's annual conference, our team presented a talk on data and the transformation of higher education in the general program. In addition, we developed formal relationships with BAE Systems, Sun-Maid, The National Military Fish and Wildlife Association, and the Air Forwarders Association. We also formally recognized our association with Lockheed Martin Center for Security Analysis, in addition to forming several other agreements and partnerships.

Two principles inherent to our culture and reflected in our outreach programs are service and leadership, which we believe are best expressed by building long-term relationships with various communities. Our goal is to build lasting partnerships with students, alumni and faculty, as well as with the military community, professional associations, corporations, community colleges and other organizations within the fields that we teach. As of the first quarter, we employed 18 military outreach professionals, and 20 civilian outreach team members to help us serve their respective professional communities. Not only did these relationships help keep our marketing costs down, we believe student referrals may improve our student persistence rates.

Our expanding presence in civilian and military communities is exciting and requires that we continue to invest in academic quality and infrastructure, especially since the growth of our civilian population has accelerated. We recently broke ground on a new finance facility in Charles Town, West Virginia to support future student financial aid requirements. In March, we began migrating undergraduate courses to our new LMS, with the goal to have all undergraduate courses converted to Sakai by the end of 2011. This process is proceeding as planned. The graduate course migration to Sakai was successfully completed last year.

As we discussed last quarter, APUS is engaged in the reaccreditation process and completed an extensive multi-year self-evaluation that culminated in an on-site reaccreditation visit by the Higher Learning Commission in February. In addition to their daily responsibilities, many of our faculty and staff were focused on providing support for this visit, as well as for the previously discussed Department of Education program review. The HLC is not expected to issue their final report until sometime this summer, and the Department of Education will not provide its final program review determination letter for some time. Additional details regarding these events and associated matters are available on our first quarter 10-Q, filed earlier today.

In summary, first-quarter net course registrations for military and civilian students were ahead of our expectations. Interest in the Walmart partnership is starting to gain momentum, and we are also seeing a pickup in our other corporate and community college relationships. Underpinning this success is the rise of the value-driven consumer, working adults who are becoming



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better-informed consumers, and who are increasingly seeking affordable, high-quality degree programs that challenge them intellectually and advance their careers. While we continue to invest in academic quality and an infrastructure to support a larger student population, our unique approaches to creating awareness are also producing a solid return on investment. In addition, we have 45 highly-trained customer service-oriented enrollment advisers who continue to take a consultative approach to enrollment and advising.

This year, as we celebrate the 20th anniversary of our founding, we continue to recognize that first and foremost, American Public University System is a university. To serve our students and the learning community, we selected an operational model that could be described as conscious capitalism. We believe that by making higher education affordable and accessible, as well as by improving the higher education experience for our nation's learners, we are at the same time enhancing our performance and effectiveness for all stakeholders.

As of March 31, 2011, approximately 90,600 students were enrolled at either AMU or APU, and we are looking forward to our graduation ceremony this June with more than 650 of 5,000 AMU and APU 2011 graduates are expected to walk across the commencement ceremony stage to receive their diploma at the Gaylord National in Maryland. Now I'd like to turn the call over to Harry Wilkins, to discuss our financial results in more detail. Harry?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

Thanks, Wally. Slide six has our first quarter update. American Public Education's first-quarter results include a 24% increase in revenues to \$58.7 million, compared to the first quarter of 2010. This growth was primarily driven by a 31% increase in net course registrations, and a 37% increase in net course registrations from new students. As mentioned on our fourth-quarter conference call, revenues in the first quarter were impacted by the timing of starts, occurring seven days later in February and March this year, which in turn should benefit revenue growth in the second quarter of 2011.

Operating income for the first quarter of 2011 was \$13.1 million, which was approximately flat compared to the first quarter of 2010. Operating margins were impacted by investments in branding, by financial aid processing and regulatory compliance costs, and by other infrastructure and growth projects. For example, during the quarter, we incurred approximately \$2.4 million of advertising expenses related to new TV, television campaign program and new radio program, which was designed to create greater APU brand awareness and ultimately lift the results of our other channels.

In addition, we incurred approximately \$0.5 million, \$500,000, which is about 0.8% of revenue, of additional expenses related to increased financial aid processing and the requirements associated with a larger civilian population. About \$0.4 million, \$400,000 of financial aid processing of IT costs, related to new program integrity rules, which go into effect on July 1 and our Sakai rollout of our new LMS, at about \$0.3 million, \$300,000 of higher bad debt expenses, which is about 0.5% of revenue, as well as expenses related to our HLC accreditation site visit and our DOE program review.

Last year, net course registrations from new students grew 19%, which is largely reflected in this year's top line growth. In the first half of 2011, growth in net course registrations from new students has accelerated, which bodes well for our future growth. As we transition to a larger civilian population, it's prudent for us to stay ahead of the curve from both a regulatory and an infrastructure standpoint. Because of our affordable tuition, we have a great opportunity to capture additional market share, increase brand awareness, and develop a larger referral base by continuing our successful civilian outreach efforts. The bottom line is that net income increased to \$7.9 million or \$0.43 per diluted share in the first quarter of 2011, as expected.

APEI remains in a strong financial position, with a strong and growing cash balance of \$96.5 million, and no debt as of March 31, 2011. For the three months ended March 31, 2011, our CapEx spend was \$3.6 million, compared with \$3.7 million in the prior year. APEI continued to purchase shares of its common stock under its previously-announced plan to repurchase common stock in connection with equity incentive plan issuances. In the quarter ended March 31, 2011, the Company repurchased 32,000 shares through its 10b5-1 plan at an average price of \$41.21.



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In short, the first quarter was marked by strong revenue growth and net course registrations for both military and civilian students. We believe this is driven primarily by our quality, affordability, and unique approach to advertising, as well as by growing numbers of value-driven consumers.

While still very early, we have seen a pickup in interest from Walmart associates, community college graduates, and from our other relationships. While impacted by the timing of starts in March, we're very pleased with the first-quarter results, and we think that success bodes well for the second quarter and beyond. Slide seven goes over our second quarter outlook for 2011. And while there are signs of improvement in enrollment of active-duty military professionals, we remain cautious on forecasting military growth, due to tightening budgets and deployments in Afghanistan and Japan and other areas of the world.

As a result of our continued success with civilian outreach, the key long-term driver of our growth, the Company expects net course registrations from new students in the second quarter of 2011 to increase approximately 27% year-over-year and net course registrations to increase approximately 25%, compared to the prior year. The Company anticipates second-quarter 2011 revenue growth of approximately 28% compared to the prior year, and second-quarter revenues are expected to be positively impacted by the timing of monthly starts. Selling and promotional expenses are expected to improve as a percentage of revenue in the second quarter of 2011, and we anticipate margins to be negatively impacted again by higher general and administrative expenses, resulting from higher compliance costs and growth investments to stay ahead of the curve.

Higher spending on infrastructure is in part a reflection of our confidence in the future growth and the continued success of our relationship-oriented approach. As a result, earnings per share for the second quarter of 2011 are expected to be between \$0.43 and \$0.46 per diluted share. One way to look at APEI's business is to consider it as a bifurcated business model. We have a mature military segment with mature margins, and a slower growth rate on one side, and a start-up civilian segment with lower margins and a much higher growth rate on the other side.

Our changing student mix impacts overall margins, despite the fact that we've become more efficient overall. Net course registrations from new students using Title IV increased 135% in the first quarter of 2011, compared to the prior-year quarter. So our mix shift has accelerated. In today's environment, we believe it's best to drive growth at a reasonable price while investing in infrastructure and academic quality to support a rapidly-growing student population.

Slide eight, titled Leading the Way. In closing, APEI is in a strong financial position. While the proprietary higher education industry continues to face a challenging fundamental environment, we believe that our university, guided by its mission is uniquely-positioned with high quality and affordability. Of course, there are risks, especially during times of regulatory change, but at the same time, there may be opportunities for a highly differentiated institution such as ours, to lead the industry by example, during this period of change. At APEI we manage for the long-term, and we believe we are creating a sustainable model that serves all stakeholders. Now, at this time, we would be happy to answer any questions from the call participants. Operator, could you open the line for questions, please?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Your first question is coming from the line of Ariel Sokol with UBS. You may proceed.

Ariel Sokol - UBS - Analyst

Good afternoon. Two questions. The first one is, so obviously a 15% share in the military is very impressive. You characterized the business as mature, but yet you still saw a 260 basis point improvement in your penetration rate in the military, so the question is, is that where do you think this penetration rate could be by the end of 2012, and by the end of 2013?



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Wallace Boston - American Public Education, Inc. - CEO, Pres

Good question, Ariel. I would say that where the rate is, is just depending on a lot of factors that are unknown at this time. The impact of DoD budgets, which we have seen a lot of comments from the current Secretary of Defense about initiatives to reduce the budgets, the impact of perhaps incorporating tuition assistance into the 90-10 calculation, which is something that has been proposed by several people, although we haven't seen any formal bill, so I think I'd rather defer an estimate on where it could be, other than saying that we intend to continue to refine our position in the marketplace, as the number one provider to DoD, continue to provide relevant degrees to military students, as well as very appropriate service, based on our experience with that market, and we'd like to grow it, but I'm not sure where it could go based on those potential external influences.

Ariel Sokol - UBS - Analyst

That's fair. And then the follow-up question, I think in the call it was mentioned that Walmart is picking up interest, perhaps a greater level of granularity can be provided regarding the success there? If it's possible.

Wallace Boston - American Public Education, Inc. - CEO, Pres

Well I think it would be possible in the future. We have always agreed, in our agreement with Walmart to jointly sign off on numbers, so we happen to be having in the next couple of weeks a meeting with their key leadership staff to review our contracts. It's been about a year since we signed it, and hopefully after that meeting we can provide some type of granularity to the market.

Ariel Sokol - UBS - Analyst

Thank you.

Operator

Your next question is coming from the line of James Sanford with Citigroup. You may proceed, sir.

James Sanford - Citigroup - Analyst

Thank you. I just wanted to touch on the competitive environment right now. We're hearing a lot of talk about traditional colleges being much more aggressive in the online space. I wonder if you could comment on anything you are seeing and obviously your price point is certainly an advantage, versus some of the other for-profit schools. Are you seeing any competition for your space?

Wallace Boston - American Public Education, Inc. - CEO, Pres

I think there are more and more traditional colleges that are actually offering degrees where you can complete 100% of the degree online. I haven't tried to compile statistics, but just as many are also offering blended programs, where you have to attend some in-person classes either a couple of weekends, or perhaps a week during the semester. When we look at these though, A, we note that when it comes to comparing against the private universities, there is no comparison, and even with the public universities, our price point is particularly attractive.

Even with in-state students where our undergraduate price point is about 10% lower than the national in-state average. The other point that I think is important to make is that right now, most of the traditional universities when they offer the online programs, they are still sticking with a traditional semester concept, so they have two, three, maybe even four starts a year but



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I've yet to see -- in fact I'm not even sure that I can tell you of anyone that is doing monthly starts, and as our familiarity with the adult student market is that monthly starts are a very big deal, and you can see that with most of the for-profits who are offering online programs.

James Sanford - Citigroup - Analyst

And just a quick follow-up. I was wondering if you could give us the starts or the courses in Q3 and Q4, excluding the one-credit lab.

Wallace Boston - American Public Education, Inc. - CEO, Pres

You mean retroactively?

James Sanford - Citigroup - Analyst

Yes.

Wallace Boston - American Public Education, Inc. - CEO, Pres

Gee, we don't have that information with us on the call, but I'll talk to Chris about seeing if we can issue something on that.

James Sanford - Citigroup - Analyst

Thank you.

Operator

Your next question coming from the line of Arvind Bhatia with Sterne, Agee. You may proceed.

Arvind Bhatia - Sterne, Agee & Leach, Inc. - Analyst

Thank you and good afternoon. A couple of questions. First on the bad debt expense going up, obviously as your civilian exposure and your growth rate continues to go higher, I am just wondering if you have taken any specific steps to maybe ensure that number stays within your comfort zone. And then in your 10-Q, you mentioned, I think there's a line that says a challenging time for the industry. Are you speaking to the cost of acquisition, leads, et cetera. Certainly demand for you is strong, I'm just wondering if you could address kind of what you are saying there in the 10-Q?

Wallace Boston - American Public Education, Inc. - CEO, Pres

Sure, I'll let Harry address the bad debt question, and then I'll try to address the second one. Harry?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

We've said all along, as we become more of a civilian school, we are going to experience bad debt, and if you look at the schools that are up against the 90-10 rules, schools that have a lot of federal aid students, they generally have 4% or 5% of revenue as bad debt. We have 1.1%, but it's up from 0.6% this time a year ago, and those are the civilians that aren't successful in their first



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course. Basically what happens is they borrow money to go to school, they don't do well. They drop out. If they get all Fs, you have to refund the money to the federal government, and you have to try to collect it from the student. And that is your bad debt risk. So we try to manage that as best we can. We still think our bad debt expense is about the lowest in the industry right now. But it will creep up, and if we had 90% civilians, our bad debt would be probably 4% or 5%. But it's going to be somewhere in that range as we become more -- right now the civilians are about half of our registrations, and it's 1.1%.

Wallace Boston - *American Public Education, Inc. - CEO, Pres*

Just to make sure I get it right, the second half of your question, could you just repeat it?

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Well in your 10-Q, I think there's a line that, you speak to your stepping up spending, marketing spending, and whatnot in light of what you say is challenging times for the industry. You feel like to gain market share, you've got to spend more. I think when you're talking about the challenging time, are you speaking about just the cost of acquisition, the leads that you're getting? Is it just getting harder, so your cost of -- you talked about your margins in this fast-growing civilian segment is going to be lower. So just wondering how you view the industry vis-a-vis regulatory risks and other things, just how you're viewing it?

Wallace Boston - *American Public Education, Inc. - CEO, Pres*

Well I think it isn't too hard just to look at the press and see that the industry is under siege, and unfortunately, good players get painted with the same brush in many of the public publications, like Bloomberg and the Chronicle of Higher Education. We never see them give a list, well we don't like these guys, but we do like these guys. Usually it's just the whole sector has issues.

So from our perspective, you have seen some companies reducing how aggressively they recruit, and their enrollments have declined and from our perspective, one of the things, we are proud of the fact that our undergraduate tuition hasn't increased in 10 years, and the way we have paid for our increased cost has been by growing enrollments, but close to 50% traditionally over the years through referrals, and still a fairly high number through referrals, even as we increase our number of civilians. The extra money we're spending on branding in the first quarter and to some extent in the second quarter as well, is really hopefully designed to bolster our own Internet lead generation.

We have found that we do a much better job of generating leads internally through our own lead generation team, because it helps us find the right type of students who are going to persist better, and that is pretty important to us for the long term. Harry, do you have another comment?

Harry Wilkins - *American Public Education, Inc. - EVP/CFO*

I just wanted to say that we think the challenging environment really impacts our competition right now a little bit more than us, and we've decided to take advantage of that a little bit, and have upped our marketing, our branding efforts so that we can get the good story of APU out there, that we are a quality program at a low cost. We really think the consumer is getting more cost-conscious and we see this as an opportunity to increase our market share at the expense of some of the competition, while they are retooling their whole admissions process.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

That makes sense. Has your view on tuition pricing changed at all in light of, again, greater exposure to the civilian market? I mean, obviously a lot of companies, your competitors have 90-10 issue, as long as military is counted towards the 10, you don't have that issue. So wondering if you are changing your view at all on tuition.



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Wallace Boston - *American Public Education, Inc. - CEO, Pres*

No, no, we continue to review that on a regular basis, which means we look at it more than once a year. At the same time, we think that if you practice what you preach, we want to provide an affordable education, and right now, we think that affordable education at the undergraduate level in particular, has really continued to generate a lot of referrals for us, even though our civilian sector is growing at the rates that it is, allowing us to supplement our advertising budget, and keep our margins relatively intact. And so we are not going to do an undergraduate tuition increase at this time. We always have options for that, but we think the better thing is to continue a practice that we have been continuing for a number of years, and that one day there may be a right time, but right now is not the right time.

And we do think we have the pricing flexibility with civilians to increase tuition if we felt that was the prudent thing to do, but our discipline in not increasing tuition is what has put us in the position we are in right now. For the last 10 years, we could have increased tuition as our competition has, but we haven't done that, and that discipline that we continue to show is what has put us in this position, which is quite enviable, I think, right now. I think we have the best priced, highest quality product in the marketplace, with pricing flexibility if we need to exercise it. We haven't managed this school ever to maximize margins in the short term. We've managed it to create value in the long-term, and that's what we continue to do.

Arvind Bhatia - *Sterne, Agee & Leach, Inc. - Analyst*

Understood. Thank you guys, and good luck.

Wallace Boston - *American Public Education, Inc. - CEO, Pres*

Thank you.

Operator

Your next question is from Suzi Stein with Morgan Stanley. You may proceed.

Suzi Stein - *Morgan Stanley - Analyst*

Hi. Just wondering, I know you don't want to give detail on the Walmart relationship, but can you maybe just give us some direction on how to think about revenue per student, and expenses associated with that?

Wallace Boston - *American Public Education, Inc. - CEO, Pres*

Well, like I said before, our agreement with Walmart is that we would both agree on releasing numbers. We did see increases in enrollment in the first quarter which we had said we would expect to see increases in enrollment in the first quarter, due to the Christmas busy season ending, and we are pleased with the relationship. We believe they are pleased with the relationship. We believe in the first quarter that they initiated some efforts to market the program on a wider basis to their associates, because it wasn't a busy time of the year so we anticipate that the relationship will continue to grow and expand, but I just can't give you the numbers at this time.



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Harry Wilkins - American Public Education, Inc. - EVP/CFO

It's a very important relationship for us, and you have to realize, they announced it in June. It really didn't roll out until August and September, so with these results that we're giving you now, we're only about six months into this relationship, which both Walmart and APUS are very pleased with, and we continue to see momentum for the opportunity that Walmart gives us.

Suzi Stein - Morgan Stanley - Analyst

Are you having discussions with any other companies for kind of similar relationships?

Wallace Boston - American Public Education, Inc. - CEO, Pres

We have periodic discussions with other companies all the time, and I think in the release here we talked about some of the companies that we signed deals with in the first quarter like BAE and Sun-Maid and the National Military Fish and Wildlife and Air Forwarders Association and Lockheed Martin, so we did see a tick up in the awareness of us as an institution after we announced our Walmart partnership, so I think that's been positive, and we have noted on previous calls that these types of corporate relationships are something you don't get overnight, that our experience is they are closer between 12 and 14 months, in many cases, to negotiate and finalize.

Suzi Stein - Morgan Stanley - Analyst

Okay. And there is some noise in the numbers, I guess, for the split between military and Title IV registrations, just because of restatements. Can you give us a better sense of what the mix of the 81,000 students is in the quarter?

Wallace Boston - American Public Education, Inc. - CEO, Pres

You mean the 81,000 --? We have a slide.

Suzi Stein - Morgan Stanley - Analyst

On the registrations, I guess we saw it for revenue but didn't see it for --

Harry Wilkins - American Public Education, Inc. - EVP/CFO

We don't have the breakdown by students.

Wallace Boston - American Public Education, Inc. - CEO, Pres

It's by payment source. If you look at the graph on the slide, I guess it's slide number three, the net course registrations by pay type TA is a very good approximation for active duty military, VA is obviously the veterans and Title IV is civilians, and cash is primarily civilians as well.

Harry Wilkins - American Public Education, Inc. - EVP/CFO

And we've historically given registration information, because we think that gives a more accurate picture of revenue, because civilian students are all over the place. You'll have a civilian student that takes one course a year, you'll have another one who



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takes 10 courses a year. So by giving the number of students doesn't necessarily correspond all the time with revenue. So we have -- we've historically given registration information.

Suzi Stein - Morgan Stanley - Analyst

I meant actually registration, sorry. Okay, thanks.

Operator

Your next question is coming from the line of Jeff Silber with BMO Capital. You may proceed, sir.

Jeffrey Silber - BMO Capital Markets - Analyst

Thanks so much. In looking at your revenue per net course registration, it went down a little bit more year-over-year than we expected. Can you just explain what is going on there, and where you think that will trend of the next few quarters, thanks.

Harry Wilkins - American Public Education, Inc. - EVP/CFO

Yes, I think Jeff, you have to consider the timing of the revenue. Remember, we go through this a lot on these calls, and we are sorry if it confuses people, but we start classes on the first Monday of every month. And we start recognizing the revenue when the classes start. So this particular quarter, because February has 28 days, February the 7th was the first Monday in February and March the 7th was the first Monday in March, so that it is as late a start as you can have for two months in a row.

So that had the impact of pushing some revenue back into -- and March was a great enrollment month for us, so a lot of that revenue is not showing up until the second quarter. So if you're just trying to match the revenue with the registrations, you have that delay that you have to take into consideration. You might want to consider deferred revenue and add that to your calculations. So if you take the revenue and adjust it for deferred revenue it might give you a better mix.

Jeffrey Silber - BMO Capital Markets - Analyst

So nothing really to do with a shift more towards undergrads up as opposed to grads, with maybe the civilians coming on board?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

Not really (multiple speakers) significant in that regard.

Jeffrey Silber - BMO Capital Markets - Analyst

Okay great, and I noticed the Company just filed a shelf registration. Can you give us a little bit more color on that?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

Sure we filed a registration statement today to take advantage of our current status as a well-known seasoned issuer, or WKSI for those of you on the call who may be attorneys, and essentially our outside advisors recommended that this gives us additional

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flexibility, and is a prudent idea to keep available all options to access capital in the future if and when we think conditions may be advantageous.

Jeffrey Silber - BMO Capital Markets - Analyst

But nothing on the horizon in the near-term?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

No. And you never know. This environment is creating some interesting opportunities out there, which we are always seem to get presented to us, and you never know.

Jeffrey Silber - BMO Capital Markets - Analyst

Fair enough, and just a couple of quick numbers questions in terms of the current quarter guidance. What should we be looking for, for tax rate and share count?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

The tax rate should be, I think, pretty consistent with the first quarter for the second quarter. So the share count will be about the same also. It will come down a little bit, because we do have this buyback that is going on. We basically bought 32,000 shares in the first quarter, and it will be something similar in the second quarter.

Jeffrey Silber - BMO Capital Markets - Analyst

Okay, great. Thanks so much.

Operator

Your next question is coming from the line of Peter Appert with Piper Jaffray. You may proceed.

George Tong - Piper Jaffray - Analyst

Hi, this is George Tong for Peter Appert. You mentioned it's possible to be in business as a combination of the mature military and start-up civilian businesses. What are your views on the steady-state revenue growth and margin targets, for both of those businesses, if you look at it separately?

Wallace Boston - American Public Education, Inc. - CEO, Pres

We really haven't given out that type of information in the past, but it is -- I think it's safe to say that the civilians -- we haven't gotten the economies of scale yet on the civilian side of the house, because it really is pretty much a start-up business at APU, so the military business is fairly mature. We market already just about everywhere there is to market in the military, so there's not a lot of incremental marketing costs. We've got great referrals in the military. So our civilian name is not as well-recognized. We have to spend money on branding. But obviously, when we get the word out, it is resonating with civilians.

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And so I think what's happening though is the shift is occurring much more quickly than we anticipated because of the civilian growth, so the shift is, even though both businesses, the margins are actually improving, our military margins are actually improving, our civilian margins are actually improving. But the shift is so much from the higher margin business to the lower margin business right now that it's kind of masking that. In time, that will correct itself.

Harry Wilkins - American Public Education, Inc. - EVP/CFO

And by the way I'm not sure that the business if it was stable would be lower margin, because civilians tend to take more classes and there's a higher percentage of them that are in grad courses. But the initial cost to process a civilian in FSA, we're not allowed to charge the students anything for that. That violates a federal rule, so we have startup costs that once they become returning students, it is much less expensive to process them.

Wallace Boston - American Public Education, Inc. - CEO, Pres

And this is a unique time in our Company's development, too. At the same time, we're experiencing an accelerating growth rate, which we need to stay ahead of, we're trying to implement these program integrity rules, there's 13 new rules which we have to have implemented and have processes in place, and IT changes to make sure we're in compliance with by July 1. So we're actually having to hire some temporary outside consultants and really ramp up our IT efforts to get all these new process changes in place by July 1 so that we will be in compliance. And that is having a little impact on margins right now also. Plus we had the site visit, we had a program review, we had some other issues in these quarters.

George Tong - Piper Jaffray - Analyst

Got it. As you are reaching out to grow your civilian student base, others are obviously simultaneously reaching out to grow their military base. Can you comment on whether you have seen any anecdotal evidence to suggest you might be seeing increased competitive pressures on the military demographic?

Wallace Boston - American Public Education, Inc. - CEO, Pres

We've seen a lot of people state that they were entering that market because of their 90-10 problems. At the same time we grew our share in a year when a lot of people said they wanted a piece of the action in the market. So I think that there are some for-profit competitors that have been pretty aggressive in the market. I think that primarily public institutions have lost market share in the market because of that. But we certainly haven't lost market share, even though there are some people that are coming back up in that. We grew it from about 12% to 16% in the last military fiscal year, so we feel pretty good, and we grew it 16% year-over-year in the first quarter.

George Tong - Piper Jaffray - Analyst

Great, thank you.

Operator

Your next question is from the line of Bob Wetenhall with RBC.



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Bob Wetenhall - RBC Capital Markets - Analyst

Good afternoon. Would it be, do you think it's a realistic goal for us to look for full year selling and promotional spending to approach \$50 million?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

We really try to shy away from giving individual expense line item guidance, and we really aren't at this point giving any guidance beyond the second quarter. So what we have historically said --.

Wallace Boston - American Public Education, Inc. - CEO, Pres

That we were going to keep it under 20%.

Harry Wilkins - American Public Education, Inc. - EVP/CFO

Exactly. We really would not want it to go above 20%.

Bob Wetenhall - RBC Capital Markets - Analyst

Okay, terrific. I'm just trying to understand, it sounds like there is a lot of one-time nonrecurring hits to G&A this quarter, and perhaps some of those will come in as well during the second quarter. Do you expect to see favorable leveraging of the G&A line item in the second half of the year?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

Actually we do, especially, I would think, toward the end of the year, as we traditionally have in the fourth quarter.

Bob Wetenhall - RBC Capital Markets - Analyst

Got it, so you are expecting some margin expansion potentially, on a consolidated basis?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

I think we should see some margin improvement in the fourth quarter.

Bob Wetenhall - RBC Capital Markets - Analyst

Okay. Are you talking about year-over-year on a consolidated basis or just for G&A?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

Most of the margin improvement, if we have it, will come from G&A.

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Bob Wetenhall - RBC Capital Markets - Analyst

Got it, and that's loaded in the second half of the year though, with particular emphasis in the fourth.

Harry Wilkins - American Public Education, Inc. - EVP/CFO

It is, it is. We really are gearing up to spending ahead of this growth and compliance.

Bob Wetenhall - RBC Capital Markets - Analyst

Great and just as a follow-up, it sounds like there is a big emphasis and shift towards civilian, and maybe Wally can answer this. What is the differential on retention levels between civilian and military students, and across the lifecycle, who is more profitable?

Wallace Boston - American Public Education, Inc. - CEO, Pres

Well actually in the multiple regression analysis that we've run, beginning in 2007 when that was our first full year for having Title IV, there doesn't appear to be a retention difference at all. Now as well as the lifecycle, we know, and our students take seven years on average to graduate. The FSA student should be a little quicker because of their need to be half-time students but we really haven't gone through a full cycle yet on a full-year of having FSA, so my guess would be that we would have a higher lifetime value for civilians, but I would tell you that we ought to have at least five years worth of data before we can really technically validate that.

Bob Wetenhall - RBC Capital Markets - Analyst

Understood, thanks very much.

Operator

Your next question is from the line of Kelly Flynn with Credit Suisse, please go ahead.

Kelly Flynn - Credit Suisse - Analyst

Thanks. Just a couple of questions. First related to the guidance for new student registrations for the second quarter, can you go into a little more detail about what's driving the slowdown? I think you said, or the anticipated slowdown. I think you basically said it was military, but is that correct, and could you drill down a little bit more into what exactly you are seeing on the military front near term (multiple speakers)?

Wallace Boston - American Public Education, Inc. - CEO, Pres

Actually for the second quarter, it's a bigger comp. In other words our quarter last year, our second quarter last year, was a much better quarter than the first quarter last year, so we have a bigger comp to go against. And 27% growth is what we are guiding to. That is similar to what we guided to in the first quarter, and so we don't really think that's a deceleration necessarily, but we will see.

Kelly Flynn - Credit Suisse - Analyst

Okay so you are not -- you are not being a bit more cautious on military due to Japan and some of the other issues?

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Wallace Boston - American Public Education, Inc. - CEO, Pres

We absolutely are cautious with forecasting military growth, because it really is beyond our control, some of the factors that influence that, but at the same time, we're very excited and pleased with our civilian growth, has done better than we anticipated, quite frankly. So it's tough to give too much guidance in that kind of a market, but we just think this is a great period of opportunity for us, and we are really excited about the civilian operations.

Kelly Flynn - Credit Suisse - Analyst

Okay, and then the second question relates to selling and promotional expense. Did you say that you expect year-over-year leverage in that line item? So as a percentage of revenue, you think it'll go down year-over-year?

Wallace Boston - American Public Education, Inc. - CEO, Pres

No, I don't think we said that. When somebody asked us about \$50 million, we said that we have not given total guidance for the year, but what we have said is that our intention is to keep that number below 20%, and we think we can do that.

Kelly Flynn - Credit Suisse - Analyst

Okay. And then finally just on kind of the regulatory stuff, I think the last couple of quarters you basically said, you haven't made many changes to the way you compensate enrollment counselors or anything on gainful employment. Can you just confirm that is still the case or any other color there would be helpful?

Wallace Boston - American Public Education, Inc. - CEO, Pres

Our enrollment counselors have always been salaried, and they always participate in the year-end bonus plan that we had. Now that has to change, unfortunately, because they are considered covered employees, as I understand that, so we have to make them pure salaried employees. But I mean quite frankly, year-end bonuses were certainly a legitimate Safe Harbor and weren't as aggressive as some of the other things that we heard people were doing, so I don't view that as a substantial change.

Kelly Flynn - Credit Suisse - Analyst

Okay. When did that happen now?

Wallace Boston - American Public Education, Inc. - CEO, Pres

It'll happen effective July 1, but we changed it effective the beginning of the year because we don't want any issues in clarity between the year-end bonus applying to covered employees, so it won't apply to covered employees.

Kelly Flynn - Credit Suisse - Analyst

Okay, thank you very much.

Operator

Your next question is from the line of Adrienne Colby with Deutsche Bank. You may proceed.



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Adrienne Colby - Deutsche Bank - Analyst

Thanks for taking my question. I was hoping you could provide a little bit more color on the BAE Systems opportunity, if you could talk a little about what trends you're seeing there in terms of enrollment, if folks are enrolling for undergraduate degrees, or if it's master level degrees.

Wallace Boston - American Public Education, Inc. - CEO, Pres

Sure. Our understanding from discussions with their human resources department is that their expectations are that most of their employees will sign up for master's degrees. We're pretty happy with the outcome to date. We have seen a number, less than 100, but a decent number, so far, register for graduate degrees. And we think that once the word spreads and typically word also spreads when employees are in the classes, and they see the quality of the programs, that we'll ramp up the enrollment there. We think the particular programs that they were interested in, it's mainly, it's currently for their US defense division, although we certainly wouldn't object if someone with BAE, and I think they have 56,000 employees in their US defense division, but we certainly won't object if some of their global employees want to participate in the plan as well.

Adrienne Colby - Deutsche Bank - Analyst

My understanding was the initial opportunity was with a smaller segment of that 56,000. You were talking about something more on the order of about 6,000, is that still the right way to think about that?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

It's open to all US.

Wallace Boston - American Public Education, Inc. - CEO, Pres

It's open to all their US employees even though the particular division that we signed it with, they have about 56,000 US employees, so I think the division we signed it with is 4,000 or 5,000, but it's open to all their employees. We would actually like to see it be open to all their overseas employees as well.

Adrienne Colby - Deutsche Bank - Analyst

Great, and if I could just sneak in one more. You mentioned that you are expecting to see some pressure on the margins on the G&A line next quarter, due to additional infrastructure spending. Just wondering if you could give us a little bit more granularity on that.

Wallace Boston - American Public Education, Inc. - CEO, Pres

I think we're going to continue to roll out Sakai, we're going to continue to race to meet the July 1 deadline, with all the changes we have to make on our website related to compliance things. Those are two big items right there. And we will continue to add financial aid staff if our FSA growth quarter-over-quarter continues at the rate that it has in new students.

Adrienne Colby - Deutsche Bank - Analyst

Thank you.



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Operator

Your next question is from Corey Greendale with First Analysis, please proceed.

Corey Greendale - *First Analysis Securities - Analyst*

Good afternoon. I wanted to start by going back to a couple of questions that have been asked on the cost side. Kelly was asking about the sales and promotional spending and Harry, I thought you did say something about sales and promotion being down in Q2. Did you mean that it could be -- that it would be down sequentially as a percent of revenue?

Harry Wilkins - *American Public Education, Inc. - EVP/CFO*

Yes. Our marketing spend would be, we anticipate, will be a little bit less in the second quarter.

Corey Greendale - *First Analysis Securities - Analyst*

Okay, that helps. And on the G&A side, I think that Bob was asking about, or pointing out that it sounded like you were saying some of this was nonrecurring. Can you just give us a sense, so the \$10.5 million of G&A in the quarter, is there some amount of that you would highlight as being more nonrecurring as you get toward the back half of the year, comes off, so maybe it could be less than \$10.5 million?

Harry Wilkins - *American Public Education, Inc. - EVP/CFO*

Well, yes. We didn't really give a specific dollar amount, but we did have some of the nonrecurring items were -- I mean we had an unexpected program review, we still had some costs, believe it or not, we got billed for, related to the Senate Health Committee compliance information request. We had these costs that are related to developing our LMS, our new LMS Sakai, our costs related to the program integrity rules, those are the one-time costs. The bad debt expense as we get more civilians is not, it's going to be a variable cost going forward based on civilians. Those are some of the line items that I would say were one-time costs. One-time costs that may be around for a quarter or two, but shouldn't be around in the fourth quarter.

Corey Greendale - *First Analysis Securities - Analyst*

I understand, and is it fair to say that if you compare the results in the quarter to your guidance, obviously the revenue was above the guidance, the high end of the guidance. The EPS came in at the low-end. Is it primarily those one-time costs that would result in -- that would cause the lower EPS despite net revenue.

Harry Wilkins - *American Public Education, Inc. - EVP/CFO*

We really made a conscious decision to spend more on S&P, as Wally alluded to in his comments, we spent \$2.4 million on TV and radio advertising, that we historically have not done a lot of in the past, because we think this is the time to let people know about APU. We really feel we have a unique opportunity to increase our market share in this space, when everybody else is struggling a little bit to kind of retool their admissions process. We are set up perfectly to kind of take advantage of that, and we have made a conscious decision to spend a little bit more money on marketing in Q1 to take advantage of that. And I think you are seeing the results with our new student growth in Q1, and hopefully that will continue to help us for several quarters.

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Corey Greendale - *First Analysis Securities - Analyst*

Okay and if I could ask one last one. Without giving away any proprietary information, if you could speak to the civilian market and outside Walmart, where are you seeing particular strength, either geographically or in terms of end markets?

Wallace Boston - *American Public Education, Inc. - CEO, Pres*

Our pilot with the radio and TV advertising in the first quarter of this year, the \$2.4 million that Harry talked about, which we didn't spend at all a year ago, was designed to enhance our in-house Internet advertising, in the buying process that the awareness when someone pulls up a lead, or a keyword phrase where we've bought a particular pop up or sidebar ad on Google, and we put that money into seven markets, and our preliminary results are that the combination of the two being very, a campaign designed to match up with Internet lead generation, or Internet lead generation being tailored for that has worked out pretty well so far.

Corey Greendale - *First Analysis Securities - Analyst*

Okay that helps, thank you.

Operator

Your next question is from the line of Jerry Herman with Stifel Nicholas, you may proceed.

Jerry Herman - *Stifel Nicolaus - Analyst*

Thanks, good afternoon everybody. Wally, a regulatory question for you, actually, on the military side. I'm wondering if you can share some of your observations with regard to the new developing MIVER process, and also maybe the voluntary partnership MOU-412. I know those are in flow, but maybe can you share some of your insights, especially relative to how you're positioned versus those.

Wallace Boston - *American Public Education, Inc. - CEO, Pres*

Sure. We had an employee, an Executive Vice President, who was on the preliminary MIVER planning committee, in fact, I think he may have been co-Chair, so we've been well aware of the process. We've been supportive of the process. We absolutely believe it's the right thing for the military to do, that there are just certain providers that if they can't meet the standards in that MIVER, they shouldn't be serving the military population. We have always said that because of our size, that we would be glad to volunteer to be the first one to go through the MIVER process.

We've looked at some of the documents that have come out recently, like the draft MOU and we don't see any surprises there. We're certainly willing to sign it and in some cases, we believe that while they are few and far between, there are occasionally bases that an ESO will only let schools that have an on-base MOU on that base, so we think that the MIVER process with the MOU, that the global MOU will actually, for distance education institutions, will be beneficial for us for those bases that we've had a little difficulty getting on on a regular basis.

Jerry Herman - *Stifel Nicolaus - Analyst*

Great and then just one quick follow-up. I realize your issues with Walmart, but I'm wondering if there is any trigger mechanism for disclosure on that business, i.e., if it reaches a certain percent of new registrations, total registrations, so on and so forth.

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Harry Wilkins - American Public Education, Inc. - EVP/CFO

I think in our agreement we call for disclosure if it's material. So far, we don't believe it's material. We're not trying to hide anything, we're just trying to comply with the agreement as it is, to be a good partner. But I do believe that if it reached the level of materiality that either our accountants or our outside counsel said we needed to do, that the agreement covers that and we can release that information.

Jerry Herman - Stifel Nicolaus - Analyst

Great, thanks guys.

Operator

Your next question is from the line of Trace Urdan with Signal Hill. You may proceed.

Trace Urdan - Signal Hill Group LLC - Analyst

Thanks very much. I wondered if you all might be able to comment on the program, the courses, the programs, that you've been developing with Walmart, whether those are done in process, whether you're actually offering those students at the moment and whether you were expecting to offer those to non-Walmart students as well?

Wallace Boston - American Public Education, Inc. - CEO, Pres

We added, I think the number we gave out was about eight courses, to put more depth into our retail management program, which is under our management degree program. And those courses have been built and offered and up and running, and we did also, as part of the agreement, develop some special classes that are actually designed to test competency and learning for Walmart Associates, so that we can evaluate whether we can award credit for them. So our feeling about it, Trace, is that we've met all the requirements for course development. The programs are there and we think that it's a pretty attractive proposition for their Associates who are interested in degrees in retail management, or degrees in transportation logistics or degrees in other subjects, because Walmart is not requiring them to only participate in those degrees. They can sign up for other programs as well.

Trace Urdan - Signal Hill Group LLC - Analyst

Those degrees are open to everybody, is that correct?

Wallace Boston - American Public Education, Inc. - CEO, Pres

That's correct, yes.

Trace Urdan - Signal Hill Group LLC - Analyst

Harry, I guess, has providing most of the color on this, and it's been really helpful in terms of what you're doing with respect to marketing, but I just wanted to, last summer when you really initiated the plan to go into civilian market more aggressively, you had kind of described a plan to market to students in a way that was sort of different from the rest of the group, and I think

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you are doing that, and I guess my question is without beating this horse to death, is it unfolding the way that you expected it to, in terms of what you are spending money on, and how effective it is? If that question makes sense.

Harry Wilkins - American Public Education, Inc. - EVP/CFO

Yes and actually it's unfolding quite well, and actually our results are better than we anticipated. Again, this is kind of a new line of business for us and we don't do marketing as traditional other schools have done, traditionally other schools have done it. And it is relationship marketing with brand recognition, and it seems to be working. It seems to be resonating. The other thing that is -- we are getting better at too, I think, is the social network marketing, and that has a lot of potential really with the civilian marketplace, so we're very excited about the results we're getting from all of our channels right now, to be quite frank.

The challenge with us is not spending the money on marketing to generate these students, it's really spending ahead of the increased interest that we're getting from civilians, and making sure that we're in compliance with regulations and these civilians, the majority of them are Title IV recipients and again, we had over 100% new student growth in Title IV recipients in this quarter. And you need to get people ahead of that. We need to get financial aid processors ahead of that so that they can continue to handle the regulatory issues related to the student population. But we're very excited about the civilian growth. It really is quite remarkable.

Trace Urdan - Signal Hill Group LLC - Analyst

Okay, and then last question, I can't remember which of you guys made this comment, but I think you made the assertion that you felt like you were actually taking share away from some other online for-profit competitors in the marketplace, and I'm wondering what your evidence for that is. Are you just looking at their numbers relative to your numbers, or are you getting feedback from admissions counselors, or where is that coming from?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

I think the comment, and I'm not sure which one of us made it, maybe both of us made it, simply that we're growing at higher rates than what we've seen in most of the quarterly announcements by the other companies that have released. And at the same time, we really haven't changed what we are doing other than we continue to do our relationship marketing and our own internal lead generation and spend money focusing on our niche degree programs that generally resonate pretty well with the working adult population.

Wallace Boston - American Public Education, Inc. - CEO, Pres

We are seeing our growth rates have accelerated quite a bit. We had 9% new student growth in the third quarter last year, 19% in the fourth quarter, 37% percent in the first quarter. We are seeing the reverse trend of that with our competition. So that's an assumption that we are taking market share. We are certainly getting more market share in the civilian marketplace. That's got to be at somebody's expense.

Harry Wilkins - American Public Education, Inc. - EVP/CFO

And by the way, Trace, I think from an affordability perspective, some of that market share may be coming from public universities that are having to shut down programs because of budgetary issues or deny access, so it's not just for-profit competitors, but I think we are bringing in some market share from places that we have always viewed as our traditional competition in the military, and now maybe some of our competition in the civilian market as well.

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Trace Urdan - Signal Hill Group LLC - Analyst

Okay, thank you.

Operator

Next question is from the line of Blair Mlnarik with Robert W. Baird. You may proceed.

Blair Mlnarik - Robert W. Baird & Co. - Analyst

Hi, thank you. Just one question. If you could provide a bit more color on the nature of the new corporate relationships that you mentioned in your comments. Are these ones that might include like a small grant or joint marketing direct billing, features like that or are you moving more towards kind of general employer referral relationships?

Wallace Boston - American Public Education, Inc. - CEO, Pres

Without giving away the secret sauce I think we try to tailor a particular program with a corporation based on the needs of the corporation. So in some instances, and they may be very focused and there may be a grant involved. In other instances there may be internal programs that they offer that we can evaluate for academic credit related to a specific program. Our goal is to be a good listener, and to try to put together a program that incorporates a tight relationship with us for the long-term.

Blair Mlnarik - Robert W. Baird & Co. - Analyst

Okay, great, thank you. And then one final one on Walmart. Have they yet decided how they are going to use the money that they have said they will put towards like employee reimbursement?

Harry Wilkins - American Public Education, Inc. - EVP/CFO

I think I said on the last call that I thought they had, and I know they have, but that's up to them to make that announcement. So it's not up to me.

Blair Mlnarik - Robert W. Baird & Co. - Analyst

Okay. That's all, thank you.

Operator

Your next question is from the line Tom Dillon with William Blair. You may proceed.

Brandon Dobell - William Blair & Company - Analyst

Hi, it's Brandon in for Tom. A couple questions for you. One, from the community college channel perspective, maybe a little bit of color on what the strategy is there. Obviously just given all the noise in community colleges over the last year, have you changed your strategy? Is that a bigger focus for you, and how do you expect that to impact the bad debt aspect of the business in the next year or two?

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Harry Wilkins - *American Public Education, Inc. - EVP/CFO*

The bad debt question, I haven't thought about, Brandon, but we're really focusing on community colleges in targeted states. We don't have the resources to go after community colleges in 50 states, so we're looking at targeted states, and targeted types of programs at community colleges where our affordability is a very big issue, compared to the affordability of their state institution, where transferability if we can do a 2.2 program with them, most times that transferability is very difficult, unless they have a partnership with a four-year public inside their state. So those are the two big strategies vis-a-vis, but picking a very small number of states that we think match up nicely with our affordability, versus the options available to the graduates of the community colleges and we're working it.

And I could be more specific but then I would probably have some people pounding on the doors from community colleges we have signed agreements with. But generally Brandon, we're going after community college graduates, so they are going to be more committed students. We have better retention historically with those, because they are proven college students. Most of your bad debt related to civilians are for students who have been out of school for a long time who really just don't succeed well in their first or second course. It isn't with people that have Associates degrees and are going for their Bachelors degrees. I would not anticipate any kind of significant bad debt experience with community college graduates.

Brandon Dobell - *William Blair & Company - Analyst*

Fair enough, and then within the overall Title IV market, a while ago you guys have talked about the impact of referrals or how many of those students were coming from some sort of referral from an existing student or a past student. Have those trends remained the same, do you see any change either way in how the referrals are impacting enrollments?

Wallace Boston - *American Public Education, Inc. - CEO, Pres*

I think at one point we had given referral numbers of the civilians were at 40%. I think the referral numbers for the civilians, simply because of the high growth, which we think is due to affordability have decreased from about 40% to 30% but that's still a pretty good number. So when you look at the blend between the military and the civilian our overall referral rate is about 43%, and it was 54%. And one of the reasons why it is actually outpacing us, because of the growth rates, we didn't anticipate new student FSA growth rates of over 100%, so it's just outpacing us more than the time it takes to build those referrals.

Clearly, we're in this for the long haul, and we continue to try to develop the referrals, and we want to develop the referrals, because I think in addition to lowering our marketing costs I think that, and I'd love to do a research paper on this sometime, I think that the referrals actually are a self-selecting process for students who refer don't want to embarrass their buddy because they flunk out, so we actually get a little better student and a better persistence rate.

Brandon Dobell - *William Blair & Company - Analyst*

That makes sense. One final question, and it sounds like you guys are pretty comfortable with all the program integrity rules being put in place. This whole issue of measuring contact time relative to definition of credit hours or threshold for credit hours, how do you guys measure contact time and anything within the recent conversations at HLC or the DOE that gives you any either cause for concern or reason to take a second look at how you're doing that?

Wallace Boston - *American Public Education, Inc. - CEO, Pres*

Well there is a philosophical answer to this which I would say on the line, with most traditional schools on the philosophical issue, and then there's the practical issue, which is we knew this was an issue beginning a while back, when they first issued the program integrity rules, so in preparation for our HLC site visit, and then it turned out that we had the program review after

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that, we had gone through and audited every one of our courses to make sure that we had a conversion factor similar to the Carnegie standard unit measurement for contact time. So both the HLC team as well as the DOE looked at those audit work papers that we had for each of our courses, and to the best of my knowledge, I think we did a good job.

Brandon Dobell - *William Blair & Company - Analyst*

Good, thanks a lot.

Operator

And with no further questions in queue I would like to hand the call back to Mr. Chris Symanoskie for closing remarks.

Chris Symanoskie - *American Public Education, Inc. - Director of IR*

Thank you operator. This concludes our call for today. We wish to thank all of today's callers for your participation and interest in American Public Education. Thank you, and have a great evening.

Operator

Ladies and gentlemen, thank you for your participation in today's call. The presentation has ended. You may now disconnect. Have a good day.

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