Aspen Group Inc.

Fiscal Q3 2017 Earnings Conference Call

March 9, 2017

Janet Gill, Chief Financial Officer

Thank you. Good afternoon. My name is Janet Gill, Aspen's Chief Financial Officer and thank you for joining us today for Aspen Group's fiscal year 2017 third quarter earnings call.

Please note that the company's remarks made during this call, including answers to questions, include forward looking statements which are subject to various risks and uncertainties. These include statements relating to expectations regarding student enrollments and other metrics, and forecasts including growth in CAGR, gross margins, net income, EBITDA and Adjusted EBITDA. Actual results may differ materially from the results predicted and reported results should not be considered as an indication of future performance.

A discussion of risks and uncertainties related to our business is contained in our press release issued this afternoon and our filings with the Securities and Exchange Commission, particularly the section titled Risk Factors in our Form 10-K filed on July 27, 2016. Additionally, to consummate the possible acquisition we announced today, we need to increase our line of credit or arrange other financing. Such risks include our ability to do so on acceptable terms.

Aspen Group disclaims any obligation to update any forward-looking statement as a result of future developments. Also, I'd like to remind you that during the course of this conference call we will discuss Adjusted EBITDA and EBITDA which are non-GAAP financial measures in talking about the company's performance. Reconciliation to the most directly comparable GAAP financial measures are provided in the tables in the press release issued by the company today. There will be a transcript of this conference call available for one year on the Company's website.

I will begin today by reviewing our operational and financial results for our fiscal 2017 third quarter, then we'll turn the call over to the Chairman and CEO of Aspen Group, Mr. Michael Mathews.

To open, quarterly revenues were $3,735,626, a 73% increase from the comparable prior year period. Although our third quarter followed our most favorable fall seasonal second quarter, we still set another quarterly new student enrollment record in the third quarter with 825 enrollments, compared to last quarter's record 811 enrollments.

Key to this new student enrollment record was the fact that we increased our enrollment center in Scottsdale from 31 to 40 people by the end of January. That increase was expected to be accomplished by the end of April, so we completed that plan 90 days earlier than forecasted. This increase of the enrollment center, a quarter earlier than expected, means that we are poised to deliver another incremental jump in our new student enrollments in the current fourth quarter. In fact, were currently tracking to deliver over 900 enrollments in this current quarter.

From a year-over-year perspective, the 825 enrollments in the third quarter was an increase of 50%, however the marketing spend of $664,000 in the quarter represented a spending increase of only 35%. That translated to our rolling six-month average cost per enrollment dropping down from $828 to $768, an improvement of 8% year-over-year.

Aspen Group's gross profit for the third quarter increased 119% from the comparable prior year period to $2,256,198 or 60% margin. This 60% gross margin result represents a 1,200 basis point improvement year-over-year. Note that our gross profits this quarter were approximately $92,000 higher than our revenues in the quarter a year ago. This certainly speaks to the superior unit economics of our business model.

Specifically, the 1,200 basis points gross margin leverage we delivered year-over-year was first a result of our cost for enrollment dropping 8% as just mentioned. Secondly, our marketing spend rose by only 35% as compared to revenues increasing 73%. Thirdly, our instructional cost only rose year-over-year by 38%, even though we had 69% more new class starts compared to the quarter a year ago.

This was our second consecutive quarter delivering positive GAAP Net Income, as we delivered Net Income applicable to shareholders of $7,377 or earnings per share of less than $0.01 per share. That's an improvement of $682,341 from the comparable prior year period.

Operating income totaled $85,694 or 2% margin, representing a $727,919 improvement from the comparable prior year period. EBITDA improved a 145% from the comparable prior year period to $218,420 or 6% margin. Adjusted EBITDA totaled $461,727 or 12% margin, a 361% improvement from the comparable prior year period.

Contributing to the company's bottom line improvement was the fact that our G&A costs increased only 29% year over year. Specifically, G&A costs were $2,133,074 as compared to $1,659,133 for the same period the prior year. From a sequential perspective, G&A costs rose by $213,421 primarily as a result of the previously discussed headcount increased in our enrollment center.

Finally, for the nine months ended January 31, 2017, cash used from operations was ($99,042), an improvement of $1,260,759 or 93% from the comparable prior year period.

Now I'll turn the call over to Michael Mathews to provide additional color on our third quarter results and to make an important strategic announcement.

Michael Mathews, Chief Executive Officer

Thanks Janet. Good afternoon everyone. As you've now heard, we actually delivered more gross profit this quarter than our revenues were in the quarter a year ago. Allow me to walk you through some of our operating metrics that led to this result.

To start last quarter, we announced that our lead-to-enrollment conversion rate was an impressive 12%. This quarter our conversion rate actually rose to 13.6%. There is no question that increasing our enrollment center from 31 to 40 people attributed to these special results. But also know that our organic or referral leads accounted for 35% of our total leads this past quarter, so word of mouth and our corporate partnerships continued to both grow rapidly.

Students paying through a monthly payment method grew sequentially from 59% to 61% of our total new class starts. That means we now have 2,575 students paying through a monthly payment method, from 2,208 a quarter ago. Consequently, the total number of monthly payment method students increased by 367 students sequentially or over a 120 per month net.

Bottom line, it's pretty clear that offering students the ability to pay for their education month-to-month has been the critical factor responsible for our outstanding conversion rate and the subsequent transformation of our financials year-over-year.

In terms of our new class start activity, students began 4,652 new class starts in the third quarter as compared to 2,753 new class starts in the quarter a year ago. That's an increase of 69% year-over-year.

To support this increase in new class starts, we have thoughtfully grown academic support systems to ensure the success of our students. Based on institutional data, we've increased the size of our advising team, increased our quality faculty (we now have 116 faculty members and 66 of them are doctorally prepared), and we strengthened our curriculum with varied virtual classroom experiences and contracted with a library service to provide 24/7 research support for our students.

As a result of our outstanding new student enrollment growth and the rapid increase of class starts over the past two quarters, we're now comfortable raising our CAGR organic guidance for fiscal years 2017 and 2018 from over 50% organic growth to over 60% organic growth.

Before I make an important announcement, I'd like to mention that our Department of Education (or DOE) program review that was conducted back in 2013 is finally nearing completion. By way of background the company returned a total of $102,810 back in 2013 to the DOE following their determination that we had not fully complied with all requirements for calculating and making timely returns of Title IV funds.

On February 8, 2017, the DOE issued Aspen a final program review determination letter related to the 2013 program review. The letter included the calculations of amounts due to the DOE for the 126 students they reviewed. We have 45 days to appeal the amounts calculated and we're currently preparing that appeal. We recognized that we'll owe some amount in the range between $80,000 to $360,000.

We expect this to be a one-time expense given that Aspen's two most recent years of compliance audits, fiscal year 2015 and fiscal year 2016, reflected no material findings relative to the calculation and timely returns to the Title IV funds, which is what caused the liability in the 2013 program review. Accordingly, we've recorded a minimum liability of $80,000 at January 31, 2017. Of that amount $55,000 was recorded against the accounts receivable reserve and $25,000 was expensed.

Okay, onto our important announcement. As you know, one of the key reasons we've been focused solely on marketing our monthly payment plans to registered nurses is because Aspen is a nationally accredited university, not regionally accredited. In the nursing sector, given that our nursing programs are accredited by the CCNE, the fact that Aspen University holds national rather than regional accreditation does not materially affect our results. That's because the vast majority of healthcare employers recognized as CCNE accredited degree without regard to whether the degree from that university is nationally or regionally accredited.

Aspen Group's long term mission however is to offer any college worthy adult the ability to earn a college degree by paying month-to-month. In order to accomplish this mission, Aspen Group has been looking to acquire a second university, one that is regionally accredited.

The long-term plan is for Aspen Group, the public company, to own two universities; first Aspen University which will over time evolve to focus solely on nursing; while the second university, the regionally accredited university, we would plan in the future to offer monthly payment plans across a wide array of online undergraduate and graduate degree programs include business, information technology, education, criminal justice, psychology, in addition to nursing.

Earlier this week, Aspen Group signed a letter of intent to acquire a regionally accredited university based in California. Today this university offers business, education, and health sciences degrees, and also offers CCNE accredited nursing programs, which we are very excited about because we believe there is easily enough demand in the nursing sector to have two huge online nursing schools in the marketplace both offering monthly payment plans. We're not disclosing the name of the university for competitive reasons and non-disclosure reasons, and also because the deal includes a confidential financial contingency that the target university must achieve by no later than December 31, 2017.

Aspen Group is committed to providing market consulting to this university to support their efforts to meet this financial contingency later this calendar year. Should this contingency or any other contingency or customary closing conditions not be met, Aspen Group can exercise its right to terminate the definitive agreement.

The total purchase price is set at $9 million, payable with $4.5 million of Aspen common stock, $2.5 million in cash at closing, and the remaining $2 million in the form of a convertible note that matures over a 2-year period after the closing. At the option of the holder, the note will convert at the market prices one year and two years from closing or be paid in cash. It was structured this way to ensure that this will be, short-term, a cash friendly transaction for Aspen, while simultaneously limiting the dilution effect to Aspen shareholders.

Additionally, Aspen has agreed to lend $900,000 to a newly formed entity controlled by the loan’s guarantor, who owns 100% of the voting power of the regionally accredited university. The loan bears an interest rate of 8% per annum. If we enter into a definitive merger agreement within 60-days of the letter of intent, and if the merger is consummated by January 15, 2018, the principle amount of the loan and accrued interest will be credited against the $2.5 million in cash payable at closing.

If the parties do not enter into a definitive merger agreement within 60 days, or if a definitive agreement is entered into but the merger does not close by January 15, 2018, and/or either party exercises its right to terminate to definitive agreement, then the loan and accrued interest will become immediately due and payable. To fund the $900,000, Aspen is drawing that amount on its existing line of credit.

In addition, to close the transaction, which we are estimating to complete late this calendar year, we’ll need to pay another $1.6 million of cash at the closing. To make that payment, and to provide ample working capital for our growth plans of both universities, we have begun discussions with a number of debt providers to replace our existing $3 million line of credit with a larger credit facility that will support our longer-term objectives.

We're confident that we will be able to secure a new facility sometime this calendar year based on the fact that we've already began to receive term sheets from debt providers.

That ends our prepared comments to this afternoon. And now we would like to open the call to address any questions.

Question-and-Answer Session

Operator

Our first question is fromf Eric Martinuzzi of Lake Street Capital. Your line is open.

Eric Martinuzzi

Thanks. Congratulations on two fronts, so the quarter that just printed as well as the letter of intent here that you've signed with this regionally accredited university. So let me start there.

The regionally accredited university, what impact does this have? I understand obviously now you are broadening out, this won't be just focused on the nursing side, it's going to be basically targeted to all adults. But let's say we move forward to that time in late calendar 2017, when the transaction has closed and also if Aspen goes from being a company that's doing maybe $13.5 million of revs and double-digit Adjusted EBITDA positive, what happens to the financials when we layer on this regionally accredited university?

Michael Mathews

First of all, the acquisition is likely to close sometime late in the calendar year, so you're not really going to see much of a material effect on our financials for this fiscal year that's starting May 1, our fiscal year 2018. However, for fiscal year 2019, the first full year after we acquire the university, we're expecting that the size of this university from a top line perspective will be approximately the same size as Aspen is today. Does that makes sense?

Eric Martinuzzi

Yes. So, as Aspen is today as in FY'17?

Michael Mathews

Yes exactly. The size of Aspen today will likely be the size of this other university in the first full year that we start working with them. They are currently smaller then us, appreciably smaller then us, but Eric, as you know once we start working with this university the growth is going to be quite rapid.

Eric Martinuzzi

I know it’s a delicate topic given the transaction hasn't closed, but any margin profile or any profit insight which you can provide us?

Michael Mathews

No, I’d prefer not to do that today. Well first of all, we signed a very strict NDA that relates to this LOI, so we really can't say much between now and when the acquisition is announced. But I'll be more than happy at the right moment to provide you guys with the understanding of how it's going to affect Aspen Group's financials in fiscal year 2018 and beyond.

Eric Martinuzzi

Obviously, it's a substantial transaction, you guys are putting $9 million of investor money to work, whether it's the common or the debt, it is obviously a transformative acquisition and that's why I asked. Let's shift back over to the legacy business. Just a terrific Q3 on the enrollment side, you blew my number out of the water with the 825 new student enrollments. You did increase the number of enrollment advisors, but are we seeing any shift here? Are enrollment advisors getting more productive or is it still pretty tightly correlated with the number of enrollment advisors? Any certain number of new students per enrollment advisor?

Michael Mathews

First of all, I do want to make the point that there has been a number of universities in the Phoenix area that have either closed or conducted layoffs over the last year or so. And we've been very, very fortunate to be able to attract very high level, highly experienced, highly qualified enrollment advisors without a lot of effort.

As we mentioned in the earnings comments earlier, we thought we would have 40 advisors by the end of April and it was very, very easy for us to get to 40 before we hit the end of the January quarter. So, the answer to your question is a little bit of both. The quality of the people is just outstanding and the performance of the entire center is improving across the board. I know we just guided this quarter that we're currently looking to exceed 900 enrollments. I want people to be aware that we're likely to beat that number by a lot. We're going to be well beyond 900 this quarter, we're absolutely exploding in terms of our enrollments.

Eric Martinuzzi

Last question from me and then I'll hand the microphone off. It's an enrollment focused question. The referrals percentage that you mentioned was just amazing to me -- the percent coming from referrals. You talked about this in the past whether it's partnerships or hospital groups or just word of mouth on the floor. Is there any structured element to this increase that took place in Q3 that you can specifically point to?

Michael Mathews

Well this goes back to the enrollment center. Probably if you had asked me the question, how many corporate partnerships do we currently hold and are leveraging a year-ago, I probably would have said maybe we had 30, somewhere in that range.

We've recently surpassed 65 corporate partnerships across this great country and so there is no question that we're seeing a lot of referrals from our corporate partnerships. And as I've mentioned before, if you give a student that's in a large healthcare organization, if you give them a great experience, he or she are going to tell all of their co-workers about the experience and this is what happens when you build a great business and you give great customer service, in our case, student service. It becomes an organic referral avalanche.

Eric Martinuzzi

To shareholder benefits. Okay, well good luck buttoning up this LOI and thanks for taking my questions.

Operator

Thank you. And our next question is from Howard Halpern of Taglich Brothers. Your line is open.

Howard Halpern

Congratulations. You used the right word, you exploded in the third quarter and I guess you are going to continue to explode going forward now.

Michael Mathews

Yes, we have a lot of momentum, Howard. Thank you for that.

Howard Halpern

I guess first question is, so you have the 40, are you going to now add just incrementally as talent becomes available to your enrollment center?

Michael Mathews

That's a good question. Just so you know, we targeted to be in the low 40s by the end of this fiscal year, which is the end of April, and we targeted to increase marginally during the calendar year. So we now have enough advisors to be able to increase our budget year-over-year by at least 30% to 40%.

So the good news here is that we basically spent the money early in this most recent fiscal quarter in order to prepare for a very, very significant growth in the coming fiscal year, and we're there. So as we continue to drive higher and higher enrollments we're not going to have to add as many call center people as we've done in the last six months.

Howard Halpern

Okay, and they have enough capacity because I would assume that they are going to be part of the consulting that you are going to do with your intended acquisition?

Michael Mathews

No. So I can't talk about the terms of our marketing consultant agreement, but please I want to make sure every shareholder of Aspen Group Inc. is aware that this will not affect Aspen's operational performance at all. We will continue to be in the low-40s enrollment advisors for Aspen and that will never change.

Howard Halpern

Okay, and I guess an additional question about the acquisition. What do you estimate the professional fees might increase in the coming quarters as you work on the acquisition?

Michael Mathews

Yes, that's a good question. In the next 60 days of course we will have legal fees and complete the definitive agreement. We will also be required to do a GAAP audit of the university over the next 60 days. And we'll also have to get a fairness opinion done with the investment bank. Also we're going to have regulatory attorney's that are going to be filing pre-approval documents with the Department of Education and to the regional creditor in the western region. So there is definitely going to be -- probably when all is said and done -- maybe somewhere in the vicinity of $250,000 to $300,000 of professional fees that will obviously be a one-time expense.

Howard Halpern

Okay, and just from the timing standpoint it seems like you have a nice long lead time, which gives you I guess a lot of runway to be able to replicate what you are doing in nursing. So you should be able to hit the ground running I guess, once the acquisition is completed?

Michael Mathews

Yes. If you want to talk about what is the five-year strategic plan for Aspen Group at a very high level? There's no reason that four or five years from now that the target university, the regionally accredited university, someday will be probably double the size of Aspen University, to give you an idea.

That's why this is absolutely a transformative acquisition for us because it allows us to take the monthly payment plan to every adult in the United States of America who is interested in getting either their first degree or their next degree. And today of course we're going gang busters in the online nursing niche and imagine a scenario where we have this gigantic nursing school at Aspen and it keeps growing (we have a couple of nursing announcements to make in the coming two quarters by the way), along with this regionally accredited university where we have the same nursing program plus all these other categories of occupational degrees as I described earlier. We're incredibly excited about this.

Howard Halpern

And one last one, just for your current operations, now you talked about adding support staff, I guess a library system. Are there more things to come, and is that going to add a little bit to the expense, but in the long term benefit the company?

Michael Mathews

We're always going to need to be adding some G&A on the academic side, whether it's additional academic advisors, whether it's additional support services for our students. And as you guys know, about a year ago we started to implement a hybrid faculty model where once a particular professor has a certain course load, we flip them to full time status because once they have a certain load, over a period of the next 12 months we actually gain $50,000 of efficiency on an annualized basis when we do that.

We've flipped close to 10 professors now over the last year and so you guys I'm sure have seen excellent leverage on the instructional cost of services line that Janet described earlier and you're going to keep seeing that kind of leverage. One of the reasons why this acquisition is so perfectly timed for us to be late this year is everyone should expect some really, really significant leverage in fiscal year 2018, and so we'll be in a position to be able to successfully start growing both universities and we'll still have really nice margins on the bottom line.

Operator

Thank you. Our next question is from Jay Eisen, an Investor. Your line is open sir.

Jay Eisen

Mike, great quarter. Is there any color on uplist of the stock, and what you kind of see that transpiring?

Michael Mathews

So, let me just say that the company is currently focused in the near term on increasing its credit facility. We're not looking at an uplist in the near term. So, we absolutely are planning to uplist and it's probably going to happen sometime before the end of the calendar year, but in terms of the capital markets, our first big move is going to be increasing our credit facility. We'll make that announcement once it's done and then we'll look to a potential uplist subsequent to that.

Operator

Thank you. Our next question is from Jeff Kobylarz of Diamond Bridge. Your line is open.

Jeff Kobylarz

I just want to make sure I understood a few things that you already noted. You said that about this California educational company, I think you said the size of Aspen today will be the size of this California entity after you put your model in place. Is that what you said Mike?

Michael Mathews

Yes, exactly and I was very specific about stating that the size of the university in fiscal year 2019 which is our first full fiscal year with this new university (assuming we close), at the end of that fiscal year we will be at the size approximately of what we will be producing for the full-year at Aspen this fiscal year.

Jeff Kobylarz

Okay, got it. And then you did say that the number of enrollment counselors that you have, that they have a capacity to handle 30% more new enrollees, did I get that right?

Michael Mathews

Yes, you did. In other words, we can spend 30% to 40% in our internet advertising spending rate at this point higher than we currently spend and we would not need to add additional advisors.

Jeff Kobylarz

Alright, great. And then just curious, in my model, I was assuming that the monthly advertising spend was going to be up versus the October quarter, but it was down, but it was down just a little bit. I have it around $221,000 a month versus $229,000 in the October quarter and can you explain why it was down.

Michael Mathews

Good observation. Couple of good reasons; number one, last quarter was our seasonal high point, the second quarter which is our fall months. So we "overspent" in the months of September and October more so then we normally would. In the third quarter that just ended, the second half of November and the entire month of December tends to be seasonally weak. And then of course January is our best month to the year.

So the spend rate was relatively similar quarter-over-quarter. I've been doing this for five years now, and we have a crystal-clear understanding of which months are the best months and we move our spending up and down to account for that. Also as we added enrollment advisors throughout the quarter this past quarter we implemented a strategy, and I hope this doesn't come off the wrong way, but we starved them a little bit in terms of new leads. Because we wanted to see how successful we could be with our existing data base which has millions and millions of leads now that we've been doing this for over five years. And I think you guys saw that it was a strategy that worked, looking at the numbers.

Jeff Kobylarz

Okay, interesting. And any general reason why the referrals keep going up? Congratulations on that. I heard you say 25% organic enrollments back in the April 2016 quarter then the last couple of quarters it was 30% and now you are at the 35%. Any general thoughts about where that can go and what's driving that?

Michael Mathews

To be honest with you, if you had said to me a year ago, “Mike what's the limit of where you’d end up,” I would have said to you, we would probably arrive at maybe 1/3’rd would be the highest we would ever get. But now there we're at 35%, I don’t know. I mean, I've never seen any e-commerce company in any sector that is in the 40% to 50% range. So I would say we'll probably tap out maybe in the 40% range, but this business model is a first of its kind business model and honestly as this is happening were making history and we're seeing what happens.

Jeff Kobylarz

Alright. And so you upped your guidance for this year's revenues, from up 50% to up 60% and can you make any comment about EBITDA? Will EBITDA be seeing a little bit more leverage? Then you just said before that EBITDA will be over the 12% level.

Michael Mathews

No, our guidance for adjusted EBITDA for the fiscal year 2017 that's just ending in a month and a half, we have said for a long time that our CAGR guidance is 50% plus and 12% Adjusted EBITDA margin. Because of the incremental spending in the call center this quarter, we basically had a couple of percent margin decline as a result.

Assuming the 50% CAGR along with the 12% margin, that backs into a full fiscal year of about $1.5 million of Adjusted EBITDA. We still believe we're going to hit that $1.5 million of adjusted EBITDA for the fiscal year, it's just going to be on a higher growth rate, over 60%. Does that answer your question?

Jeff Kobylarz

Yes, that's fine.

Michael Mathews

And you will see very material improvements on our adjusted EBITDA margin in this fiscal year that's going to start in May 2018.

Jeff Kobylarz

And the driver of that is what?

Michael Mathews

Leverage with growth. We're getting to the point where we're big enough that we don't have to add as much G&A as we have in the past and as you can see our direct costs every quarter are getting better and better in terms of our efficiency. I talked about the instructional costs earlier about how that's declining as a percentage of revenue.

Operator

Thank you. This time there's no other questions in queue. I'd like to turn it back to Mr. Mathews for any closing comments.

Michael Mathews

Thanks everyone for your time this afternoon. I appreciate all the questions and I'm looking forward to speaking with you in our fiscal year end fourth quarter a few months from now. Have a good day. Thank you.