

FINAL TRANSCRIPT

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COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

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May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the third quarter 2011 Corinthian Colleges earnings conference call. My name is Teresa and I will be your conference coordinator for today. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. As a reminder this conference is being recorded for replay purposes. I would now like to turn the conference over to your host today, Ms. Anna Marie Dunlap, Senior Vice President of Investor Relations. Please proceed, ma'am.



May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Anna Marie Dunlap - Corinthian Colleges - SVP IR

Thank you, Teresa. Good day, everyone. Thanks for joining us. I'm here today with Jack Massimino, Chairman and Chief Executive Officer; and Ken Ord, Chief Financial Officer and Chief Administrative Officer. This call is being webcast and an audio version of the call and transcript will be available on Corinthian's website for 30 days. In addition, a telephonic replay of this call will be available until Tuesday, May 10.

The details for accessing replay are included in the press release we issued this morning. Please note that during this conference call we may make projections or other forward-looking statements regarding a variety of issues. These statements are based upon current information and expectations. Actual results may differ materially based on a number of risks, which are identified in our filings with the Securities and Exchange Commission. And, with that I will turn the time over to you, Jack.

Jack Massimino - Corinthian Colleges - Chairman & CEO

Thanks, Anna Marie, and good morning to everyone on the call. In the third quarter, we continued to make progress in several areas, including student outcomes, compliance, and financial and operational management. We continue to take action to make sure that our programs provide positive student completion and placement outcomes and have made enrollment adjustments in some programs to ensure a better match between graduates and job openings. We began piloting new entrance assessment test for online and campus-based students. We have made substantial progress in reducing cohort default rates and as a result have decided to begin serving ability-to-benefit students again on a limited basis. In anticipation of the new federal program integrity rules, which go into effect on July 1, during the quarter we developed compliance plans and have now implemented a new compensation program for admissions and financial aid personnel across all US campuses.

In the area of financial management, we have implemented a reduction in force, slowed our role out of new campuses, continue to automate our financial aid processing and implemented other efficiencies. We are now working on next year's fiscal budget and expect to find additional cost savings as we move through the budgeting process. We'll provide more detail in several of these areas as we progress through today's call. With that introduction, I will now turn to our third quarter results, followed by a review of regulatory matters. Ken will then review the third quarter operational and financial metrics in more detail and provide guidance for the fourth quarter. Our third quarter results were well within our most recent guidance ranges for revenue, diluted earnings per share and new student enrollment.

In the third quarter, revenue decreased by 3.3% compared with the same quarter of the prior year. Primarily the result of a decrease in the average student population. The decrease is mainly the result of our decision to stop enrolling ability-to-benefit, or ATB, students as of last September 1. Total new student enrollments declined by 21.5% in the third quarter versus the same quarter last year. Excluding the loss of ability-to-benefit enrollments, new student enrollment declined by 4.3%, primarily reflecting general industry conditions and our recent price increases associated with the 90/10 rule. As reported in today's press release, third quarter diluted earnings per share were \$0.21 compared to \$0.45 in the same quarter last year, excluding a severance charge of \$2.4 million.

The charge relates to the workforce reduction we implemented in the quarter. Operating margins, again excluding the severance charge, declined to 6.3% in the third quarter from 13.9% in the third quarter last year. The deterioration is primarily the result of declining enrollment in the Everest ground schools and losses associated with our new campuses. I will move now to the area of student outcomes, starting with career placement. As discussed on previous calls, in fiscal 2010 we significantly increased the number of placement personnel in our schools, in part to offset the impact of the weak economy. We now have approximately 750 career services representatives and we're currently focused on helping our 2010 and 2011 graduates find employment in their fields of study. In calendar 2010, over 60,000 students graduated from our schools, a 28% increase over the prior year and a new company record.

May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Current trends indicate that our placement rate for the 2010 cohort of graduates as of June 30, 2011 will be slightly lower than our placement rate of 73% for the 2009 cohort of students at the same point last year. Even so, we expect to place approximately 42,000 graduates, which will be a substantial increase in the total number of placed graduates compared with last year. We continue to refine our approach to career placement and we're seeing increased success with national employer partnerships. During the third quarter, we announced partnerships with four employers, Adecco Medical & Science, PepBoys, Republic Services and Skip Barber Racing School. These types of partnerships demonstrate the value of our career program and they are expected to help increase our placement rate over time.

In addition, we continue to monitor closely the student outcomes of our programs to take steps to improve their performance and to make adjustments as needed to our program offerings. Year-to-date, we ended 41 programs and we determined that they did not meet our completion and placement expectations. To put this in context, we have approximately 1,150 diploma and degree programs in total. To help improve student success, we are piloting new assessment tools for prospective students at Everest ground schools and Everest online. We have an open admissions policy at our Everest schools and the new assessment tools will not change that policy. The assessment test will replace existing test and help us do a better job of determining the extent to which students require remediation.

For example, in the online learning division pilot, we are using a standardized proficiency exam, which will classify prospective students into one of four categories from lowest risk to highest risk. When the program moves beyond the test phase in 2012, the highest risk students will be required to participate in a free online Academy, which they must successfully complete before being allowed to begin their degree programs.

Next, I'm going to make a few comments about enrollment trends. As I said earlier, there were three main issues impacting enrollment in the third quarter -- our decision to stop enrolling ability-to-benefit students; general industry conditions; and our recent price increases associated with the 90/10 rule. First, I'll discuss issues related to ability-to-benefit students. As previously reported, we stopped enrolling ability-to-benefit students at our Everest and WyoTech ground schools effective last September 1.

In the third quarter, the loss of ability-to-benefit students reduced new enrollments by approximately 6,400 students. Our decision to stop serving ability-to-benefit students last fall was one of several measures to reduce cohort default rate. It was a difficult decision to make, as serving ability-to-benefit students has historically been part of our admission and most of these students have very few options for obtaining post secondary education. As we reported in March, we're seeing dramatic improvement in our default rate trends beginning with the 2010 cohort of students. The 2010 cohort included the largest percentage of ability-to-benefit students in our history. We've learned a great deal as a result of this experience about how to support ability-to-benefit students and assist them in meeting their loan obligations.

As a result, we believe that our new plan for serving ability-to-benefit students will not have a significant impact on our default rate. Consequently, last week, our Board of Directors approved management's proposal to serve ability-to-benefit students again starting in June. As we begin serving ability-to-benefit students again, we plan to put new limits in place. For example, only the best performing campuses will be allowed to serve ability-to-benefit students. We plan to increase entrance and academic standards for ability-to-benefit students and to provide GED test preparation at no charge. As a result of these changes, we expect to enroll approximately 3,000 to 5,000 new ability-to-benefit students in fiscal 2012 versus approximately 20,000 students in fiscal 2010. Returning now to other issues impacting enrollment in the third quarter.

We continue to believe that economic and general industry conditions, continued negative publicity and the uncertainty around new and pending regulations had a negative impact on new student start growth in the quarter. In addition, as previously reported, we increased tuition pricing for new diploma students on February 1 and for new degree students on April 1. The increases were taken to help the company remain in compliance with the federal 90/10 rule beginning of fiscal 2012. Our trend data show that increases taken on February 1 is having a negative impact on new enrollment. Accordingly, we reduced new enrollment guidance and issued a press release to that effect in mid-March. For many of the reasons just discussed, we expect the rate of new student loans to be down in the fourth quarter compared with the same quarter last year.



May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Our expectation is that new student enrollments will decrease by 24% to 27%, reflecting the loss of ability-to-benefit students in the quarter, as well as general industry conditions and internal decisions related to tuition pricing and student outcome. Excluding the loss of ability-to-benefit students in the quarter, new enrollments are expected to be down by approximately 8% to 11% in the fourth quarter compared with the same quarter last year. On the growth side, inquiries from new students ranged favorable across our programs and Ken will provide more specifics on that in a few minutes. We continue to see mid-teens new student growth in our online learning division. Our high school program for the Everest ground schools which participate generated 12.8% of total new enrollment, up from 9.1% for the same quarter last year.

The number of high school seniors who have submitted an application to start school was up 26% in the third quarter this year compared with the same period last year. In addition, opening new campuses continues to be an important source of enrollment growth. We opened two new campuses in the third quarter, both in the Chicago area. In total, we've opened seven new campuses in the last 12 months and they are exceeding our growth expectations. We plan to open three new campuses in fiscal 2012. Lastly, we continue to expand our core program offerings at numerous campuses. Thus far this fiscal year, we've introduced 33 new programs.

Next, I'm going to move to a discussion of regulatory issues starting with cohort default rates. As we reported in mid-March, we now estimate that our average two-year cohort default rate, or CDR, for the 2010 cohort of students will be 9% to 12%. This is a major improvement over our average preliminary two year CDR of 21.9% for the 2009 cohort and our average final two year CDR of 19% for the 2008 cohort. Given the improvement in our projected 2010 CDR, we believe we are no longer at risk of exceeding federal default thresholds under the current two year measurement rules.

We also believe that we've significantly reduced our risk under the new three year measurement rules. Of course, given our high default rates for the 2009 cohort, we expect a substantial number of our institutions to exceed the 30% threshold under the three-year rule for the 2009 cohort. However, we do expect marked improvement in CDRs for the 2010 cohort and beyond. We attribute the improvement in the 2010 CDR to three main factors -- first, our substantial investment in cohort default prevention over the last 18 months; second, stabilization in the wake of structural changes in student lending and the transition to direct lending; and third, the increased participation of loan servicers and default management.

I will move now to California's new eligibility requirements for the Cal Grant program. In late March, Governor Jerry Brown signed into law California Senate Bill 70, a budget reduction measure. Among other things, the new [bill] modified California grant eligibility requirements for students and institutions. When these changes take effect, assuming California uses a revised trial three year default calculation issued by the Department of Education on April 21, our students will have to replace approximately \$5.2 million in Cal Grant funding with other sources, primarily Stafford loans. We are disappointed that these students will have to assume increased debt to attend school. Next, I will discuss implementation of the Department of Education's new program integrity rules.

Our internal compliance team has taken the lead in assessing the program integrity rules promulgated last October. We've organized a multi-disciplinary effort to implement the 13 new rules, plus the disclosure portion of the gainful employment rule. Most of these rules take effect July 1, 2011. As discussed on past calls, the new rule related to prohibited compensation payments for personnel engaged in admissions and student finance activities will have the most significant impact on our organization. The new rule eliminates enrollments as one of the allowable factors to be used in evaluating job performance of admissions personnel. This differs from the previous rule which allowed enrollments to be one of many factors to be considered when evaluating employees.

To comply with the new compensation rule, we have implemented a new performance evaluation program for front line admissions and student financial aid employees. The new compensation plan is based upon three areas -- surveys of prospective students regarding their satisfaction of the enrollment experience; knowledge of school programs and admissions and financial aid rules and processes based upon periodic testing; and structured observation of each representative. In addition, we plan to continue our program of mystery shopping our enrollment process and we are preparing to roll out a post enrollment



May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

verification process. Our goal with post enrollment verification is to help ensure that new enrollees understand the implications of their decision to attend school.

It will also help us validate our enrollment process and training and preemptively address any potential misunderstandings before students begin their programs. We've been piloting the enrollment verification process and the initial results have been encouraging. We expect the verification program to be implemented throughout the company in fiscal 2012.

I want to comment briefly on one other regulatory issues, the removal of year around Pell Grant, which I think has been a source of confusion among analysts and investors. As part of the continuing budget resolution passed in April, Congress eliminated year around Pell Grant. The availability of the year-round Pell is short-lived, as it went into effect on July 1, 2009 and will be eliminated as of July 1 of this year. The key point is that we expect this change to be immaterial for our company.

Even with the removal of year-round Pell, students can still qualify for Pell for each academic year of their programs. For the vast majority of our students, the elimination of year-round Pell won't change whether they receive their grants or the amount of their grants. It could shift the timing of their grants. We have new enrollment periods occurring throughout the year, which also minimizes our exposure to removal of year-round Pell compared to more traditional institutions. As a result of the removal of year-around Pell, we expect that about 1,700 students will have to replace approximately \$2 million in Pell Grants in fiscal 2012. And, because these students qualify for Pell, it is highly likely that they will be able to replace their grants with federal Stafford loans.

As with Cal Grants, although this is immaterial to our company, it is certainly a negative for those students affected. Before turning the time over to Ken, let me summarize where we stand today. We're taking a number of steps to reduce risk and improve student outcome and we are bringing expenses in line with our current and projected enrollment. Inquiries from new students remain favorable. Our high school program and new campuses are growing as planned and we will begin serving ability-to-benefit students again in June.

We've made substantial progress on cohort default rates and no longer expect them to pose a significant risk. As Ken will discuss shortly, we've also made excellent progress in managing bad debt. We're implementing the new program integrity rules thoughtfully and on schedule. In addition, as you would expect, we continue to be active participants at the federal level working toward regulatory solutions that are effective for our students and our schools. With that, I'll turn the time to Ken for a more detailed review of the quarter and fourth quarter guidance.

Ken Ord - Corinthian Colleges - EVP and CFO

Thanks, Jack. I'll start with marketing cost trends. Total marketing and admissions expenses as a percent of revenue increased to 23.2% in the third quarter this year from 20.4% in the same quarter a year ago. This increase is primarily the result of an increase in admissions compensation expense. Media generated inquiries or leads, which exclude inquiries from referrals and high school representatives, increased in the third quarter compared with the prior year.

Moving now to education services expenses, including bad debt, education services expenses as a percent of revenue were 59.5% in the third quarter of fiscal 2011 versus 54.2% in the same quarter last year, an increase of 530 basis points. The increase primarily relates to the addition of default management personnel, academic program chairs, instructors, and the costs associated with opening new campuses.

In the third quarter, bad debt was 4.8% of revenue, up from 4.3% reported in the same quarter last year. The slight increase in bad debt expense was primarily the result of issues associated with the transition of our third party financial aid processor to the federal direct lending program.

May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Overall, however, we are pleased with the trend in bad debt. As part of our financial aid re-engineering initiative, we are in the process of bringing title IV profits in-house. As a result, we've substantially reduce the loan funding cycle, which reduces AR, bad debt and improved cash flow. The transition to the internal processing is expected to be completed by the end of May.

Next, I will move to capital expenditures. In the first nine months, capital expenditures totaled \$88.9 million compared to \$52.2 million in the same quarter last year. The increase in capital expenditures is primarily the result of opening several new campuses. I will move now to enrollment data, followed by a few items on the balance sheet and cash flow statement. More detail on our financials can be found in our press release and in our third quarter 2011 10-Q, which will be filed by the end of this week.

The total student population at March 31, 2011 was 102,450 students, including 26,063 students exclusively online. In the third quarter the average student population was 106,638, down 2.2% from the same quarter last year. Moving to the balance sheet, at March 31, 2011, we had approximately \$40.3 million in cash and cash equivalents versus \$209.4 million at June 30, 2010. Long-term debt, including the current portion as of March 31, 2011, was \$204.3 million, which includes capitalized obligations up \$13.8 million.

At June 30, 2011 long-term debt was \$314.3 million, including capitalized lease obligations of \$14.2 million. Net day sales outstanding in the third quarter were 17 days. On the cash flow statement, cash flow from operations was \$53.6 million for the nine months ended March 31, 2011, compared with cash flow up \$210.7 million for the nine months ended March 31, 2010.

The decrease is primarily due to lower net income and the timing of cash receipts and payments related to working capital, primarily prepaid tuition, accrued expenses and accounts payable. Prepaid tuition was negatively impacted by approximately \$57 million, primarily the result of the transition of our third party [profit] to the federal direct loan program. Cash disbursements related to accounts payable and accrued expenses were negatively impacted by approximately \$66 million due to the timing of payments.

I will move now to fourth quarter guidance. As we discussed in our last -- on last quarter's call, we're currently providing quarterly guidance only. Given the uncertainty in the regulatory environment, we are not in a position to provide annual guidance. In addition, our fourth quarter guidance excludes any one-time charges.

We expect fourth quarter guidance or our results to be as follows. For the reasons discussed earlier, we expect new student enrollment to decline by 24% to 27%. If we exclude the loss of ATB students in the quarter, we expect new student enrollment to be down 8% to 10%. We expect revenue to range from \$422 million to \$433 million in the third quarter. We expect diluted earnings per share to be approximately \$0.11 to \$0.13. We assume approximately 84.9 million diluted shares outstanding in the fourth quarter and the tax rate is expected to be approximately 40%. That concludes our guidance for the quarter, so, back to you, Jack, for closing remarks.

Jack Massimino - Corinthian Colleges - Chairman & CEO

Thanks. Ken. In closing, we're making progress in several important areas, including student outcomes, compliance and streamlining key business processes. We're committed to continuous improvement to insure that students are well served in terms of the completion, placement and overall value proposition. We're taking necessary steps to match expenses with current and projected student enrollment and positioning the company for future growth.

We're making excellent progress in our default mitigation efforts, both on federal and internal loans. Our financial aid re-engineering initiative has helped us reduce bad debt substantially. We're managing through the impact of continued uncertainty on the regulatory front and we are on track in terms of implementing new program integrity rules. We continue to be active participants in the legislative and regulatory progress, educating policymakers about the value we bring to students and the impact of proposed and existing regulation, including gainful employment and 90/10.



May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

As I think most of you now know, our understanding is that the proposed gainful employment rule was sent to OMB yesterday and we'll wait to hear what they have to say and what it includes and will be prepared to talk to you about that as soon as we know more. In spite of the regulatory challenges, we see ample opportunity for continuing to serve our current student demographic. We believe our role in providing entry-level career training is vital to the economy and in short supply.

States are cutting higher education budgets, so students need alternatives to traditional public institutions now more than ever. Further, our student outcomes meet or exceed those of community colleges and at a comparable costs to the taxpayer. We'll continue to update you on our progress as we move forward. Let's now move to the question-and-answer session. As in the past, please limit yourself to one question and one follow-up. If time permits, we'll get back to you for a third round of operation. And, operator, I will turn the time back to you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Trace Urdan with Signal Hill.

Trace Urdan - Signal Hill Group LLC - Analyst

Jack, I listened to what you said about bringing the ATB students back in, but I'm still a little puzzled by the decision given that we have not yet seen the gainful employment regulations. And that my understanding all along was that this was at least in part a measure that was intended to boost all of the outcomes measures, including repayment divorced from the default calculations. So I am wondering if you can comment on that? Why do you have the confidence that you're not going to need to then reverse course once again once you see what the final gainful employment rules look like?

Jack Massimino - Corinthian Colleges - Chairman & CEO

I think a couple of things, Trace. First of all, we have been very successful with regard to cover default rates and our improvement. The mitigation of that issue for the organization really is on track and is working well for us. I think when you think about the fact that in that 2010 cohort, that is our largest group of ability-to-benefit students that we have had in the history of the Company, yet we still were able to move down that default rate. We feel pretty good about it. And when I talked to you about that I'm not talking about bringing 20,000 new students into the program. I'm talking about bringing 3,000 to 5,000 students into the program. So if you think about it, that is going to -- we'll continue to see as a result of that percentage of the total, a continued reduction in default rates.

As important as all that is, remember that these students that are coming into the program are coming into diploma programs, which are in a much better position from our perspective with regard to gainful employment, certainly as we knew it in the last -- over the course of the last six months. So I think all of those things taken into consideration, our board felt very strongly, as did our management team, that these are students who deserve a shot and as a result of that we're going to give them a shot to the maximum of our ability and that is 3,000 to 5,000 students. I mean, you will not see us increase that dramatically beyond that level. You won't see us doing 20,000 students a year again.

Trace Urdan - Signal Hill Group LLC - Analyst

I appreciate that. And then maybe as my follow-up. There's so much attention focused on Everest for understandable reasons, but I'm wondering if you could maybe just give us a little bit of an update on Heald and what kind of trends you are perceiving there and what you think the forecast looks like for that part of your business looking out through the year?



May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Jack Massimino - Corinthian Colleges - Chairman & CEO

Well, I'll tell you, Trace. We are very -- obviously, you have heard say this in the past, but we are pleased with the Heald transaction. They are performing in excess of where we thought they would. Certainly at the time we developed it their budgets have been good. They continue to perform well for us. So we are very pleased with that transaction. We think they could have some issues under gainful employment, but not as significant as some of our other programs because they're pricing is a lot less overall. So Heald, we think, is in a pretty good position as well. I can't say much more other than we are pleased with it.

Trace Urdan - Signal Hill Group LLC - Analyst

Thank you.

Operator

Bob Wetenhall with RBC.

Bob Wetenhall - RBC Capital Markets - Analyst

You guys have done a pretty good job managing CDRs and looking out I just wanted to understand what is your biggest concern on the regulatory front moving forward? Is it just still the ambiguity of gainful employment or I will let you answer it?

Jack Massimino - Corinthian Colleges - Chairman & CEO

No, I mean, thanks, Bob, but that is the answer. The ambiguity around gainful employment is the issue we are concerned about. We are also concerned about 9010. We are paying attention to that as well and we are implementing mitigation strategies around that in the organization also. Those are our two primary focuses and as we get this new gainful employment rule, we will have a chance to take a look at it. As you might expect, we have been running a number of models around what we knew gainful employment to be in the last cycle. We have all been told, you have been told, people are speculating about it, that we are going to like what we see. I'll call that when we see it. But once we know what they have than we will have an opportunity to take a look, see how it fits with our strategies and then we will tell you what we are going to do about it and what the implications will be for the organization, but those are the two things that I worry about the most.

I think as I said before, gainful or 9010, I said this on the last call, I mean we knew that was an issue. It was the real deal. We had to deal with it. I wasn't about to put the organization in a place where we would have problems with the Department of Education around meeting that obligation. And so we took the action that we deemed was necessary. Assuming Congress does something, which may or may not help them. As I've said in the past, we will rollback that price increase. But I think -- so we put -- we've dealt with 9010 as best we can in the short term. There are a number of other strategies that we're looking at for the long-term on 9010, but gainful is still the one thing I think that we don't know enough about at this point to give you any specifics about. But those are the things I worry about.

Bob Wetenhall - RBC Capital Markets - Analyst

Fair enough. And just to follow-up. Is there -- within the P&L is there any particular line item that you guys can modify in terms of the cost structure to help stabilize margin performance going forward?

May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Jack Massimino - Corinthian Colleges - Chairman & CEO

Yes, I think that we are clearly doing that. You just saw us do a reduction in force that we took a write down for in the quarter. We are in the middle of the budgeting process now. A big piece of our operations, particularly around the facility stuff, is fixed. Others are very variable, others are kind of a stepped variable, and so we work on every one of those. Some of them take a little bit longer to realize. When you think about academics, as an example, we may be slowing down on enrolling the students, but our attrition is getting better and our population is still there, so we still have an obligation to take care of those students and so those costs, which are somewhat variable, come down slower than other costs, which are very variable, like eliminating positions and things of that sort. So, we are doing all of that. We have spent the last several months actually going through a process here internally of aligning our expenses with our revenue as we look forward into next year and we are in the middle of that process with budgets as we speak.

Bob Wetenhall - RBC Capital Markets - Analyst

Fair enough. Thanks very much.

Jack Massimino - Corinthian Colleges - Chairman & CEO

Thanks, Bob.

Operator

Jeff Silber with BMO Capital Markets.

Jeff Silber - BMO Capital Markets - Analyst

Ken usually give us some lead information. I'm not sure if you gave that or if I missed it. I think just repeat that, I think, and just generally talk about what is going on on the lead side as well in terms of costs, et cetera? Thanks.

Ken Ord - Corinthian Colleges - EVP and CFO

Yes, well actually given the statistical noise that was created by the removal of ATB inquiries, we really now plan to just give you overall trend information rather than providing specific numerical data. It just got a little noisy as we tried to filter out specific lead information and make sure it was apples to apples. We are doing that generically, but we will give you that directional input, but we won't be giving you a number per se.

Jack Massimino - Corinthian Colleges - Chairman & CEO

Yes, Jeff, we are in the process -- I mean, we have ATBs going out. We are going to have ATBs coming in. This lead flow is going to move around categorically quite a bit over the next little while. And our view was we just create more questions than answers and so we can give you directionally how it is doing, it is a heck of a lot easier for all of us.

Jeff Silber - BMO Capital Markets - Analyst

And I'm sorry, my follow-up question was also on cost, if you could talk generally what is going on by the different verticals, that will be great.

May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Jack Massimino - Corinthian Colleges - Chairman & CEO

The different verticals meaning the --

Jeff Silber - BMO Capital Markets - Analyst

(inaudible) in terms of lead costs.

Jack Massimino - Corinthian Colleges - Chairman & CEO

Oh, lead costs. Pretty flat Jeff across the board. For all three.

Jeff Silber - BMO Capital Markets - Analyst

Thanks so much.

Operator

Sara Gubins with Bank of America Merrill Lynch.

Sara Gubins - BofA Merrill Lynch - Analyst

Could you talk a bit about the profitability of ability-to-benefit students given that you are probably going to have to screen them a bit more and provide GED test prep at no charge, et cetera, just wondering how you think about the profitability there?

Jack Massimino - Corinthian Colleges - Chairman & CEO

I think, Sara, that these students are not unlike the rest of our students. We do certain things for ability-to-benefit students, we do other things for other students. Whether it's providing bus transportation, whether we are helping with day care, I mean we do it for all of our students. And these students really are an exception to that. We may do a little more remediation with them, but those numbers are historically built into our cost structure because I have got a heck of a lot of them already in place. So as a result, we should see actually an decrease in the cost associated with them and it also depends on the capacity of the particular campus that we are dealing with. So there are number of things that go into them, but those costs associated with ability-to-benefit students are already built into our structure.

Sara Gubins - BofA Merrill Lynch - Analyst

And I don't know if you can comment on this, but do you think the decision to take in some ATB students again is enough that you would be able to grow your start base next year?

Jack Massimino - Corinthian Colleges - Chairman & CEO

Well look, the overall question is where is the bottom. I think that's really what you're asking whether ability-to-benefit makes a difference. We are talking about 3,000 to 5,000 students over the course of the year. Our comps get better or easier, I guess, in the second quarter of the next fiscal year, that October to December time period, and so we are looking forward to that.



May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Sara Gubins - BofA Merrill Lynch - Analyst

Thank you.

Operator

Kelly Flynn with Credit Suisse.

Kelly Flynn - Credit Suisse - Analyst

The question relates to the default management success. I know you cited basically the drivers, I was wondering could you give us a sense of how much of it was your better default management versus the direct lending disruption stabilization?

Jack Massimino - Corinthian Colleges - Chairman & CEO

Kelly, I think it's certainly all three of them. I think we have to take credit for a big part of it with our own default management program, all the effort we put into place, all the education we're doing in the schools. I do think clearly we saw a nice helping hand when the third party started to help out, because prior to that it was us, by ourselves trying to deal with this issue. And when the third party administrator stepped in and started helping out that give us a little bit of a boost. So I would say probably maybe 60% us and 40% everybody else. But I think that that's well in excess of where we were historically and that is a guess on our part. We did see a nice boost when the third parties entered the fray and started helping us out.

Kelly Flynn - Credit Suisse - Analyst

And then on that note, basically when you talk about default management how much of that is forbearance in deferrals versus actually the students beginning to make payments?

Jack Massimino - Corinthian Colleges - Chairman & CEO

Yes, it's a little bit of all of that. I would say that we were pleasantly surprised by the percentage of our students that are going into deferral as opposed to forbearance. Deferral is much more complicated, they've got to meet certain requirements to get into there. Forbearance, as you well know, is a pretty easy, just a question you have to agreed to it and you're on your way. But deferral is a much better place to be and deferral statutory as opposed to forbearance. And so we are pretty pleased with where that is. Our repayment rate really has not moved a whole heck of a lot from where it was prior to this effort. Now as we have stabilized are positioning, we are really moving much harder into that whole collection effort and it is bearing fruit for us. That is where the focus is going to be on a go forward basis.

Kelly Flynn - Credit Suisse - Analyst

Okay perfect and then just switching gears, Jack, you talked about a number of initiatives, but I wanted to touch back on the enrollment verification and then the new admissions compensation. Can you just review the timing of the rollout of each of those? I think the latter you said was done, but when do those fully roll in and what impact, if any, are you anticipating on the enrollment figures? Thanks.

May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Jack Massimino - Corinthian Colleges - Chairman & CEO

Okay, let's do it one of them at a time. With regard to the rollout of the compensation plan, that's out. It is in place. It went into place effective April 1. We have been working on that for a considerable amount of time. From the time we knew about it we started putting together teams to deal with it. And so we have had lots of internal progress on that. We actually rolled it out April 1 and the truth of the matter is the numbers that you are looking at that we are looking at it lead us to believe that it is working pretty well for us. We don't know ultimately how it's going to work, because we need two or three more months of experience with it, but we wanted to get it in place prior to the July 1 date so we weren't trying to handle it all at one time. And actually begin to have a well oiled machine by the time the requirements roll into place.

I think we are ahead of the curve on that. We feel very good about where all of that is. And an awful lot of work went into that with a whole lot of outside help, as you might imagine. With regard to the enrollment verification, just so you all know, this is something that I did in the healthcare business with our Medicare program a long time ago. And we had 1 million plus Medicare members that we went through a verification process with. And we have been thinking about doing it in the organization for a period of time. And we are currently in a pilot phase. We've probably run about 400 or 500 students through the enrollment verification process at this point. We like the outcomes that we are seeing, as a result of that we feel good about the education that our admissions folks are and financial aid service are giving to our perspective and new students.

But we think it is going to be a great help in terms of, again, just more training and what it will really do for us is it will really begin for us to make sure that the students understand what they're getting into. And if at the end of the day they have an issue, we can mitigate at the time. I think it's just a much better program all the way around for them. And so currently we're doing it, I think, in a number of our new schools. We are doing it online. So we are in a pilot phase with that. Our expectation is that we'll have it rolled out completely across the organization throughout the next fiscal year.

Kelly Flynn - Credit Suisse - Analyst

And just to clarify on the first point about the comp plan. It was just April 1, I guess it wasn't really reflected in the quarter and have you seen any productivity hit from it and do you expect the impact to be material?

Jack Massimino - Corinthian Colleges - Chairman & CEO

No, we have not seen any productivity hit. You are right, it was not in the last quarter. It is in this new quarter, but we have not see a productivity hit as a result of it. And you know it is early in the process, Kelly. It will take us some time to shake through this whole thing. I am less concerned about our admissions advisors than I am about our mid-managers. It is a bigger change for them than it is with the admissions folks. But, we are paying a lot of attention to it and that's why we gave ourselves the three month run to get it in place prior to the implementation date. So, I think at that point, Kelly, I am going to give somebody else a chance.

Kelly Flynn - Credit Suisse - Analyst

Yes thanks.

Operator

Jerry Herman was Stifel Nicolaus.

May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Jerry Herman - *Stifel Nicolaus - Analyst*

Some questions about costs, if you will. Can you help us put the \$60 million in savings into the various P&L line items. Maybe give us some guidance on that? And then also, as part of that, can you talk about the, let's call it an update on fixed cost structure and facility in educational services? That would be helpful.

Jack Massimino - *Corinthian Colleges - Chairman & CEO*

Okay. I'm just making a note, Jerry, so don't lose it. On the people piece, that was across the board. I mean it was at the corporate headquarters, at the divisional headquarters and in the schools. And as we -- as some of the classes begin to shrink down, we will start consolidating and so there will be some faculty. There was some faculty that were in that process as well. So just broadly.

Ken Ord - *Corinthian Colleges - EVP and CFO*

And I would just say the bulk of that would be educational services and admin probably in the proportionate of those two on the financial. Less of it going to marketing and admissions.

Jerry Herman - *Stifel Nicolaus - Analyst*

Very helpful.

Jack Massimino - *Corinthian Colleges - Chairman & CEO*

And then on the fixed cost structure, as I said earlier, certainly the facilities there is a component of our structure that is fixed and that is about -- fully fixed is about a 30% piece of our structure and probably 20% is very variable. And in the middle pieces of step variability equation and I think that is the process that we go through. We know that when we have facilities, as facilities hit the bottom and we start to enroll and come up, we know that the contribution rate goes up fairly dramatically just as it goes down dramatically when you go through this kind of structure or have this kind of loss of population in the schools. We are looking forward to the other side of it, as we did five or six years ago. It is the same kind of set of circumstances. I don't see it any differently than that, Jerry, as we look forward. So if you think back to what happened five or six years ago in the organization as we stemmed the enrollment drops or the outflow and started to bring students back into the organization, that contribution margin started to improve over time. So, I think we are in the same kind of circumstances now. I hope that's helpful.

Jerry Herman - *Stifel Nicolaus - Analyst*

That is helpful. And just for the follow-up. Can you update us on the Genesis loan program, i.e. usage, number of students average loan amounts and so on and so forth?

Ken Ord - *Corinthian Colleges - EVP and CFO*

Sure. I think we indicated in the last call that as a result of the price increase we took to help the 9010 process, it changed our outlook in terms of ultimately the impact of the amount of student lending that we have over a 12 month period. And that roughly doubled it from approximately \$120 million run rate in terms of the growth loan that we would expect students to take over the course of a year to almost \$240 million to \$250 million. I mean the average loan size for an Everest student is \$2,500 to \$3,000. And a significant number of our students do have a Genesis loan. Some of which the WyoTech students can obviously get a higher balance and some students would have a minimal balance. But those are the, I think, the primary questions that you asked.

May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Jerry Herman - *Stifel Nicolaus - Analyst*

Great. That's helpful. I appreciate.

Jack Massimino - *Corinthian Colleges - Chairman & CEO*

Thanks, Jerry.

Operator

Paul Ginocchio from Deutsche Bank.

Paul Ginocchio - *Deutsche Bank - Analyst*

It looks like from your guidance, if I'm calculating correctly, that your revenue per student for the June quarter is going to be flattish. I'm just trying to understand that in relation to your 12% price hike. Are some of the 41 programs that you have closed recently, are those some of the higher-priced programs? Thanks.

Ken Ord - *Corinthian Colleges - EVP and CFO*

Well, the biggest impact on that is the mix consideration between really diploma and degree programs. Diploma average revenue per student is higher than the average revenue per student for a degree program. And given the growth in online and the growth, frankly, in Heald, relative to our Everest ground schools, you are seeing a mix change that would move degree programs up in terms of that mix and diploma programs down in percentage of that mix. And that has the further, frankly, impact on the revenue per student of making it, as you say, more flattish.

Jack Massimino - *Corinthian Colleges - Chairman & CEO*

And I think it is fair to say, Paul, that of the 41 programs, they are not the higher cost programs. They are just typical programs for the organization.

Paul Ginocchio - *Deutsche Bank - Analyst*

And where those programs in any one field of study?

Jack Massimino - *Corinthian Colleges - Chairman & CEO*

No they were half and half, about half diploma and half degree.

Paul Ginocchio - *Deutsche Bank - Analyst*

Great, thank you.



May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Operator

Peter Appert to with Piper Jaffray.

George Tong - Piper Jaffray & Co. - Analyst

Hi, this is George Tong for Peter Appert. Could you give us a sense of whether the 3,000 to 5,000 is your expected long-term studies, the ATB enrollment figure or whether that is just a figure for 2012?

Jack Massimino - Corinthian Colleges - Chairman & CEO

I think that ultimately we're thinking that it could be around 10% of our population, that is kind of the top bar that we are talking about, but it is 3,000 to 5,000 in '12.

George Tong - Piper Jaffray & Co. - Analyst

Thanks. And as a follow-up, what specific steps are being taken to prevent CDRs from experiencing upward pressure as you begin to enroll ATB students again?

Jack Massimino - Corinthian Colleges - Chairman & CEO

Is real simple, George, we're continuing to pay attention to it. You don't forget about it. We just keep doing what we are doing. A lot of educational programs in place, with a lot of focus on it in the organization. We do what we are doing, CDRs are not going to be an issue for us.

Ken Ord - Corinthian Colleges - EVP and CFO

And in our experience we have already been able to see that in the early days, the default rate on those students was more like two times a normal high school student. That has been brought down already to like 1.2 times. So we already seen it in the data, so maintaining even what we are doing right now will significantly prevent how what we have seen happen in the past.

George Tong - Piper Jaffray & Co. - Analyst

Great I appreciate.

Operator

Suzi Stein of Morgan Stanley.

Suzi Stein - Morgan Stanley - Analyst

You talked about graduate placement rates, but can you also address graduate salary trends? Has there been any material change there? And would you be willing to give us some idea of the starting salary of your graduates?

May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Jack Massimino - Corinthian Colleges - Chairman & CEO

A, there has been no change. I mean, we are not seeing any material change either up or down. And B, it depends on the program, Suzi. It can vary on medical systems to WyoTech to degrees, I mean it's all over the map. So, we have not done it historically and frankly I don't know what it is to those programs and I would just be winging it and I'm certainly not going to do that.

Suzi Stein - Morgan Stanley - Analyst

And then just a follow-up question. Are you comfortable with your cash position just given the uncertainty around gainful employment and can you talk about additional liquidity sources, particularly as results for the industry deteriorate as a result of whatever comes out of the regulations?

Jack Massimino - Corinthian Colleges - Chairman & CEO

I am always concerned about cash. When I have it and when I don't have it. So there is a lot of focus on that here in the organization and Ken certainly can speak to that. But there are a number of things that we can do that we have done historically. We have a number of facilities, for example, that we own and we have historically done some sale and lease backs and other opportunities to raise cash we could certainly and would like to liquidate our loan portfolio at the right price. It would make some sense to something like that. So we have a number of vehicles that we could use to generate additional cash if we got into that kind of circumstance. I don't want to get into a tight pinch, because at the end of the day than the valuations on those begin to deteriorate because people know they have you up against the wall. That is not where we are headed. So works for all those opportunities and have been, frankly, for quite a while.

Ken Ord - Corinthian Colleges - EVP and CFO

Well and we feel very much more comfortable now that we have put our own financial aid reengineering in place, because the ability to control our own destiny in terms of that is huge. And obviously, we were hurt in the first six months of this year as our third party processor had difficulty in the direct loan program. But now I think we monitor cash very closely and that working capital deterioration in the first half was not something we wanted and going forward with what we call fair financial aid reengineering. We are very much more confident in being able to maintain that steady stream of a healthy working capital flow.

Suzi Stein - Morgan Stanley - Analyst

And maybe if I can just sneak one more in. Just a follow-up on the comments you made on bad debt. As you get through some of the processing changes, what would you consider kind of a normal percentage of bad debt?

Ken Ord - Corinthian Colleges - EVP and CFO

Well, I think in the past, I mean again every quarter there, I think, potentially (technical difficulties) give kind of quarterly guidance, but I think we will be able to be below that 5% threshold. And if we are under that threshold I think we are feeling pretty good. And we will drive it as far down as we can, but under 5%, I think, is going to be healthy.

Suzi Stein - Morgan Stanley - Analyst

Okay great. Thank you.

May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Operator

Mike Tarkan with FBR Capital.

Mike Tarkan - FBR Capital Markets - Analyst

So on the CDR improvement, it has come a lot quicker than I would have expected. I am just wondering have we started to see some improvement on 9010 as well, given our tuition increases and the mitigation strategies you are going implementing. And then, I guess, how long you think it will take till we see some meaningful improvement there?

Jack Massimino - Corinthian Colleges - Chairman & CEO

Well, with regard to CDR, it's come along, but it didn't come along fast. It took us 18 to 24 months once we started focusing on it, stop going down blind alleys, adjusted our approach. So I wouldn't say it was fast. I would say it was competent. I would say it was very well done. Fast would -- it depends on your view, I guess. But I think we did it within a good time period and got the outcomes we were looking for. The big change that really kind made it much quicker, really was this third party help that we were getting, because when you are doing it by yourself, it is a whole different set of circumstances, but when there are a number of you out there doing it, it does help. Students are getting the kind of contact they need. And the educational programs that we put into place probably are the single most, the single biggest driver of the process. We spend a lot of time with the students, talking to them about their responsibilities and helping them understand what their obligations are upon graduation, when this is going to happen.

And I think as important as that is, Mike, one of the things, one of the benefits that has come out of this is that students now know that if we call them, they will return our call or they will take our call because were not calling them to beat them up, we're calling then to help them. And that's, I think, from a just a mental perspective, psychological perspective, is a big switch from where a number of the companies where I think a number of years ago. So I think that's been very helpful. With regard to 9010, I think certainly our price increase mitigated, assuming Congress isn't going to raise Stafford amounts and program money. I guess that's probably a pretty good assumption. It's mitigated through vast majority of our schools at the moment. There are some things coming our direction. As we all know, next year we lose the ability to count our own institutional loans and so we are working towards a resolution there.

Ken Ord - Corinthian Colleges - EVP and CFO

Then 2011.

Jack Massimino - Corinthian Colleges - Chairman & CEO

Yes, I'm sorry, the 2000. I'm sorry. But that starts to -- no, a year from now, that starts to have an impact on us. So we are working on mitigation strategies on that. We have a number of things in place already that we think will help us. Just our own loan portfolio program helps us in that regard. So there are number of things that we're doing that we think can help out. We have to continue looking at third party revenues. And trying to balance a little bit of new business into the organization that fits our mission and will help us mitigate some of this 9010 stuff and clearly we have got some focus on that. As does everybody else in the space. It is amazing to me, but I feel sometimes like we are the only guys that you think have a 9010 problem, but we have moved well beyond it, I think, and have started to mitigate the problem. And feel pretty good about where we are.

Mike Tarkan - FBR Capital Markets - Analyst

Okay great. And then I guess back to ATB. Can you just talk about your ATB outlook in the context of 9010 as well?

May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Jack Massimino - Corinthian Colleges - Chairman & CEO

Well, the ATBs are no different than any other student coming into the organization. They have the same kind of eligibility for Stafford and Pell Grants, Stafford loans and Pell Grants as any other student. I don't expect any more impact from ability-to-benefit students than I would from high school graduates. It is the same set of circumstances.

Mike Tarkan - FBR Capital Markets - Analyst

Thanks.

Operator

Gary Bisbee with Barclays Capital.

Gary Bisbee - Barclays Capital - Analyst

Just following up on the earlier commentary on cash flow. I think, Ken, you mentioned a couple of these working capital timing issues that you faced year-to-date. Can you give us a sense when those reversed, assuming you expect them to, and would it be reasonable to think you will be free cash flow positive this year or if the timing lingers into early next year as we look out going forward?

Ken Ord - Corinthian Colleges - EVP and CFO

Will if you noticed that this quarter itself, we generated probably \$50 million of operating cash flow as opposed to virtually zero in the first half. And the outlook we would do similar, something similar in the last quarter of the year. And as we look forward to next year we will be generating positive operating cash flow. And frankly positive free cash flow. So, yes, we are monitoring it fairly closely, and frankly, feel it like we have really gotten by most of these one-time (technical difficulties) negatively impact working capital.

Gary Bisbee - Barclays Capital - Analyst

Okay. And then the follow-up. Did I hear you right that online starts, you said, were up mid-teens? And I guess that compares favorably to several of your peers. I wonder if you had any commentary on how you are generating that success or what programs are doing well or anything there would be great? Thank you.

Jack Massimino - Corinthian Colleges - Chairman & CEO

Gary, I think that it's -- Anna Marie was just telling me smaller base and I think that's really right. A lot of these guys have a much bigger organizations and much bigger student population than we do. So I think that's part of it. I think we do a pretty darn good job. I don't want to take -- I want to give credit where credit is due, our online people do a very good job. They are very sophisticated in their approach. We've got a number of programs that we offer like a lot of folks do. And we continue to do well there. We have slowed down our online growth ourselves by putting stops to a number of programs that they currently offer or slowing down particular programs that they currently offer. So that 15% mid-teens kind of number feels pretty good to us given the actions that we have taken internally.

May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

Gary Bisbee - Barclays Capital - Analyst

Thank you.

Operator

James Samford with Citigroup.

James Samford - Citigroup - Analyst

I just ought to keep following up on the online piece a little bit. Just wondering if you could provide us maybe just a little bit more color on maybe next quarter's expectations for online and maybe a longer term? Right now we are at roughly, what, 25% of your enrollment is online only? Is that something that you could see getting to the 40% level over time or is the campus part of your strategies still the core part of the business?

Jack Massimino - Corinthian Colleges - Chairman & CEO

Well, the campus is clearly part of our core strategy and our online business is an adjunct to that strategy, albeit that we do have 26,000 students fully online. Our expectation in the numbers that we gave you is pretty much the same as this quarter for online. We're not expecting any increase or decrease from there. James?

James Samford - Citigroup - Analyst

Great. That's about it.

Jack Massimino - Corinthian Colleges - Chairman & CEO

I think we have time for one more question.

Operator

Gordon Lasic with Robert W Baird.

Gordon Lasic - Robert W. Baird & Co. - Analyst

I had a question about persistence trends in the fiscal '12? Given that you are adding more ATB students next year related to this year, how should we think about persistence in that context? We were under the impression that's more of a headwind, but I think last quarter you talked about that those student actually completed a higher rate, so can you give a little bit more color on that?

Jack Massimino - Corinthian Colleges - Chairman & CEO

Yes, I want to say two things to make it very clear. First of all, we have 106,000 students. We are talking about 3,000 to 5,000 ability-to-benefit students. So the implications across our entire organization are not significant. When you have 20,000 it is a whole different set of circumstances. Our persistence is -- has been improving. I am not going to give you a forecast for persistence into next year. We'll give you some ideas around that as we get into the August timeframe and give you guidance for the next

May. 03. 2011 / 4:30PM, COCO - Q3 2011 Corinthian Colleges Inc Earnings Conference Call

fiscal year. But the point I wanted to make is that we are talking about 3,000 to 5,000 ability-to-benefit students. Keep that in mind as you think about where we are headed organizationally.

And we feel very good about our ability to deal with those students that are only going into our campuses where we have had great success in the past. We have put a number of limits on this program to guarantee our success with it. And let me just tell you, we are paying a lot of attention to it. And one of the things our organization does well is when we pay attention to things they work out the way we think they're going to. And so I think it is incumbent upon us to pay attention. Yes, so we are talking about 3,000 to 5,000 new ability-to-benefit students. So, with that I think I'm going to end the call. I appreciate your time this morning. Want to thank everybody who participated. And we look forward to seeing many of you at the upcoming conferences and at the time of our fourth quarter report in late August. Thanks, everybody.

Operator

Ladies and gentlemen, thank you for your participation. That concludes the conference. You may disconnect and have a wonderful day.

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