



Education Notes

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2010 – So What Happened?

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Highlights

- Since the June 24th Senate Hearings, the publicly traded schools stocks are down 27%, where are we headed?
- Is the Government focus on the for-profit sector and the current witch hunt they are conducting just a tactic to avoid the real issue – *that our system is deteriorating?*
- We are very disappointed with the behavior of our politicians in the hearings they have been conducting on the for-profit sector. We agree that bad players need to be weeded out, but we view the sector as a key driver in how we fix the mess that has been created of our education system.
- The U.S. is now ranked 12th in college attainment for 25 – 34 year olds, a far cry from our ranking for all adults (25 – 64 year olds) 3rd.
- Hope everyone has a relaxing and peaceful holiday!

Arcady Bay Partners Invests in JTC Education and StraighterLine

Arcady Bay Partners recently made “Angel” investments in these two companies. Ed Meehan also joined the board of StraighterLine

Thank You to InterEd

There is a great site that has been put up by InterEd with much of the materials prepared in response to the Senate Hearings. [Click Here](#)

Industry Information

Please visit our website at www.arcadybay.com for copies of this review and other industry information.

Valuations – The Pain Was Felt By All

Below are market valuations for the public companies as of Friday December 17th with the industry trading at approximately 1.1x trailing revenues and 4.0x trailing EBITDA.

Publicly Traded Company Financial and Valuation Data

ARCADY BAY PARTNERS

12/17/2010

Symbol	Company	Stock Price 12/17/2010	52 Week		TTM Sales	Market Cap	Enterprise Value	EBITDA	Enterprise Value to		EBITDA Margin
			Hi	Low					Rev.	EBITDA	
APEI	American Public Education	\$ 35.52	\$ 48.95	\$ 23.84	\$ 186	\$ 638	\$ 538	\$ 54	2.9 x	9.9 x	29.2%
APOL	Apollo Group	38.48	66.69	33.75	4,930	5,690	4,910	1,500	1.0 x	3.3 x	30.4%
BPI	Bridgepoint Education	17.75	27.50	12.75	653	927	682	213	1.0 x	3.2 x	32.7%
CPLA	Capella Education	62.00	98.01	56.44	406	1,030	822	107	2.0 x	7.7 x	26.4%
CECO	Career Edu Corp	19.53	35.88	17.00	2,090	1,590	1,160	438	0.6 x	2.6 x	21.0%
COCO	Corinthian College	4.46	19.31	4.23	1,880	376	519	310	0.3 x	1.7 x	16.5%
DV	Devry Inc.	46.04	74.36	36.34	2,010	3,230	2,650	505	1.3 x	5.2 x	25.1%
EDMC	Education Management Corp.	14.02	26.79	8.75	2,640	1,970	3,000	609	1.1 x	4.9 x	23.1%
LOPE	Grand Canyon	18.65	28.46	15.33	363	853	839	92	2.3 x	9.1 x	25.4%
ESI	ITT Education	62.72	121.98	50.00	1,560	2,000	1,830	630	1.2 x	2.9 x	40.4%
LINC	Lincoln Educational	15.54	28.21	9.73	630	345	360	147	0.6 x	2.4 x	23.4%
STRA	Strayer Education	158.18	262.44	124.01	612	2,140	1,980	226	3.2 x	8.8 x	36.9%
UTI	Universal Tech. Inst.	\$ 22.11	\$ 26.77	\$ 14.55	\$ 416	\$ 537	\$ 432	\$ 65	1.0 x	6.6 x	15.7%
Total					\$18,375	\$21,326	\$ 19,721	\$ 4,897	1.1 x	4.0 x	26.7%
Average (Simple)					\$ 1,413	\$ 1,640	\$ 1,517	\$ 377	1.4 x	5.3 x	26.6%

As of December 17th, the equity market capitalization of the industry was \$21.3 billion, representing a 27% decline from its June 21st value, right before Steve Eisman testified before the Senate on June 24th. As can be seen from the chart below all companies have seen their valuations drop. Base upon market capitalization, Corinthian has been the biggest loser and UTI has been the least impacted.

Over the same period, the industry has seen their trailing sales grow 11% and their trailing EBITDA grow by 17%, so in the short-term growth has continued but future growth is expected to be drastically lower for all and negative for some.

So it seems that the Senate hearings have had their intended impact and slowed down the growth of the for-profit colleges. The overhang of the Gainful Employment rules should continue to pressure stock prices and in all probability increase operating costs for the for-profit sector, if increase reporting is required.

It is a shame that all this time and effort and the continuing investigation has done little to discuss how we fix our public education system, which serves many more students in the country and relied upon \$72 billion of state and local appropriations in 2006-07 (statistics from NCES) to fund their operating losses. (William Blair in their industry research estimates total taxpayer subsidies to be \$125 billion.)

% Change from June 21, 2010 to December 17, 2010

ARCADY BAY PARTNERS

12/3/2010

Symbol	Company	Stock Price	TTM Sales	Market Cap	Enterprise Value	EBITDA
APEI	American Public Education	-26%	14%	-28%	-32%	9%
APOL	Apollo Group	-20%	10%	-22%	-28%	13%
BPI	Bridgepoint Education	-14%	24%	-17%	-26%	63%
CPLA	Capella Education	-28%	13%	-29%	-35%	19%
CECO	Career Edu Corp	-27%	8%	-27%	-35%	32%
COCO	Corinthian College	-60%	15%	-62%	-52%	11%
DV	Devry Inc.	-19%	12%	-20%	-27%	17%
EDMC	Education Management Corp.	-20%	11%	-21%	-18%	14%
LOPE	Grand Canyon	-24%	23%	-24%	-21%	27%
ESI	ITT Education	-33%	10%	-38%	-41%	13%
LINC	Lincoln Educational	-31%	7%	-41%	-40%	13%
STRA	Strayer Education	-34%	12%	-36%	-40%	13%
UTI	Universal Tech. Inst.	-12%	5%	-11%	-16%	13%
Weighted Average			11%	-27%	-31%	17%

Postsecondary Education – A System that Serves Everyone but the Student...

As we look at the state of our education system in the current economic downturn it seems that:

- No one is happy about the rising cost of postsecondary education
- State and local appropriations, which provided \$72 billion (in 2006–07) to lower public college tuition charges, will continue to be under pressure
- The nations competitive rankings continue to decline
- There is little effort in the education system to reign in costs or embrace innovative technology solutions
- Annual endowment donations, which were \$27 billion in 2009, continue to primarily go to colleges that already have large endowments and do little to assist students with real financial need
- The postsecondary education system, in many ways, looks the same way it did 100 years ago

It seems that in many ways the education system in the U.S. is more concerned about alumni, faculty and real estate development than it is about students. When an industry's focus turns inward on serving its constituents, rather than outward toward its customers, its survival ultimately is in question. We saw this clearly with the automobile industry and the below we see a comparison to the Newspaper Industry.

Last year, Kevin Cary, of Education Sector (an industry think tank) wrote an interesting article comparing colleges to newspapers, here are some excerpts:

Newspapers are dying. Are universities next? The parallels between them are closer than they appear. Both industries are in the business of creating and communicating information. Paradoxically, both are threatened by the way technology has made that easier than ever before.

*In 1997 the legendary management consultant Peter Drucker said, "Thirty years from now, the big university campuses will be relics. ... **Such totally uncontrollable expenditures, without any visible improvement in either the content or the quality of education, means that the system is rapidly becoming untenable.**" Twelve years later, universities are bursting with customers, bigger, and (until recently) richer than ever before.*

*But universities have their own weak point, their own vulnerable cash cow: lower-division undergraduate education. The math is pretty simple: Multiply an institution's average net tuition (plus any state subsidies) by the number of students (say, 200) in a freshman lecture course. Subtract whatever the beleaguered adjunct lecturer teaching the course is being paid. I don't care what kind of confiscatory indirect-cost multiplier you care to add to that equation, **the institution is making a lot of money — which is then used to pay for faculty scholarship, graduate education, administrative salaries, the football coach, and other expensive things that cost more than they bring in.***

*Less-selective private colleges and regional public universities, by contrast — the higher-education equivalents of the city newspaper — are in real danger. Some are more forward-looking than others. Lamar University, a public institution in Beaumont, Tex., recently began offering graduate courses in education administration — another traditional cash cow — through a for-profit online provider, with the two organizations splitting the profits. It's an innovative move and probably a sign of things to come. But the public university still looks like something of a middleman here — and in the long run, the Internet doesn't treat middlemen kindly. **To survive and prosper, universities need to integrate technology and teaching in a way that improves the learning experience while simultaneously passing the savings on to students in the form of lower prices.***

See: <http://chronicle.com/article/What-Colleges-Should-Learn/15693> April 3, 2009

The Senate Hearings – Very Disappointing

We are still dumbfounded that Steve Eisman was allowed to address the U.S. Senate Committee on Health, Education, Labor and Pensions on June 24th. Letting a short-seller of industry stocks testify on the “Socially – Destructive” For-Profit Education industry is sad and shows how politicians spin issues. I just hope someone eventually discloses how much Eisman’s firm made shorting the industry since his testimony, maybe Wikileaks?

Here is the link to his testimony:

<http://help.senate.gov/imo/media/doc/Eisman.pdf>

The Center for College Affordability issued a paper on for-profit education in July 2010. It was well balanced and thoughtful, here is an excerpt:

*“The recent growth of the for-profit education industry has aroused some criticism and concerns about the place of profit in an educational setting and practices within the industry. Critics argue that for-profit universities are simply diploma mills that push students through programs of dubious quality with the primary goal of increasing the firm’s bottom line. Supporters of the industry assert that it provides educational opportunities to traditionally underserved students in areas of study that directly increase students’ employability. While neither extreme view is likely to be completely accurate, **there is no doubt that for-profit educational institutions are becoming a much more prominent part of the higher education landscape.**”*

http://www.centerforcollegeaffordability.org/uploads/ForProfit_HigherEd.pdf

Shame on Senator Harkins

I find Senator Harkins to be doing very little to improve our education system. In the report issued last week on the for-profit Military colleges it was stated that “For-Profit Schools are Higher Cost”. It goes on to say “According to one recent study, over time the tuition at for-profit schools has averaged six times the cost of community college, and roughly twice the cost of public four-year institutions.¹⁸”

The report cited was prepared by the American Association of Community Colleges ([click here for link](#)) and has a bit of a bias. It says that “Community colleges continue to offer the lowest tuition in higher education” as shown in the excerpt below.

“Community colleges continue to offer the lowest tuition in higher education as a basic part of their access strategy. According to the College Board (2010b), as of fall 2010, the average tuition for a fulltime, full-year community college student was \$2,713.”

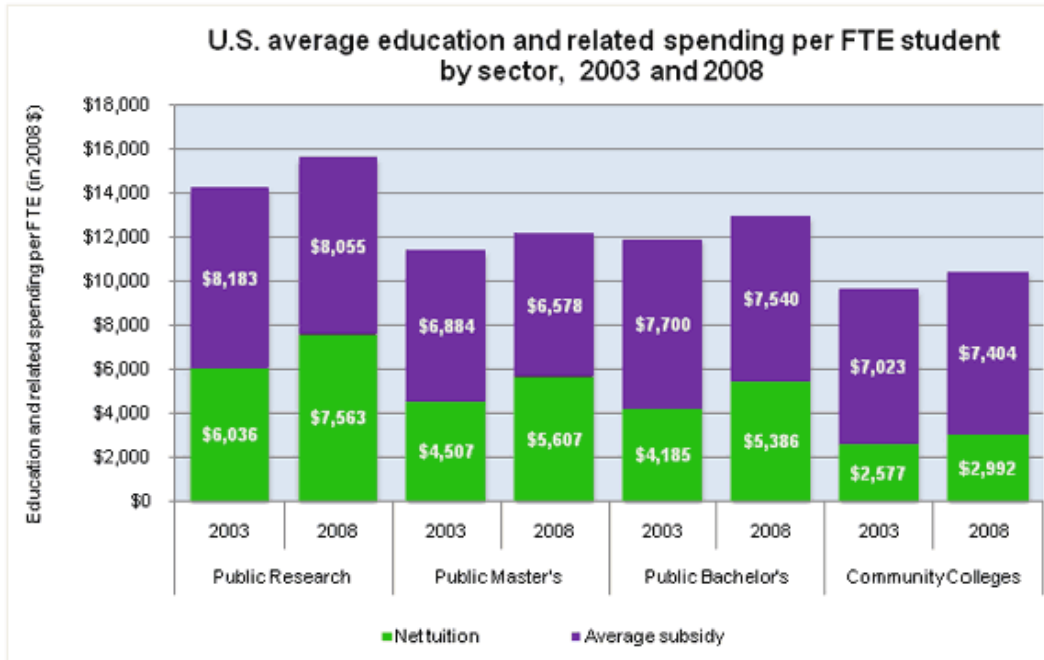
“For-profit schools have substantially higher tuitions than do community colleges. In fall 2010, according to the College Board (2010b), the average tuition at a for-profit school was \$13,395.4 Over time, the average tuition at a for-profit institution has been about six times higher than the average community college tuition and roughly twice the average tuition at public 4-year institutions.”

If we look at research below done by the Delta Project, they estimate that each full time community college student has their annual tuition subsidized by approximately \$7,400. The majority of these subsidies are state and local appropriations that totaled \$72 billion in the 2006-07 school year.

I would hope that as these debates continue that we at least compare the actual cost of education not just the net tuition charge.

It is also important to point out here that these state and local subsidies are granted to all who attend, not based upon need and have no cap on how many years a student may attend. So a student from a well-to-do family could spend 6 years at a community college and have the taxpayers absorb \$44,400 in costs and never graduate. Today, over

a three-year period approximately 25% of community college students finish their two-year associate degree.



Source: <http://www.deltacostproject.org/data/national/>

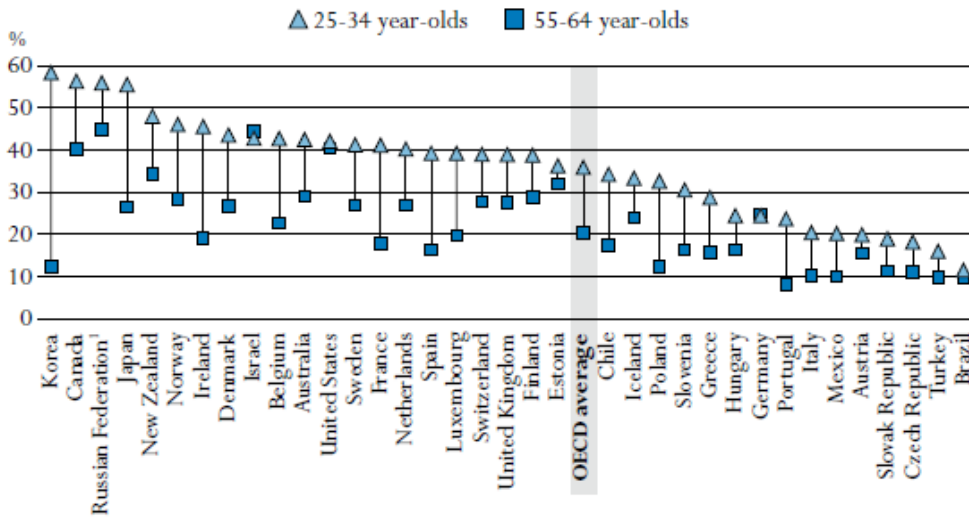
College Attainment – The Growing Issue

The OECD recently released **Education at a Glance 2010**. Below is a chart on college attainment that shows the U.S. ranked 12th in college attainment for 25 to 34 year-olds. It is interesting to see that we have not improved educational attainment between older and younger generations, while most others have.

Chart A1.1. Population that has attained tertiary education (2008)

This chart compares the population aged 25 to 34 with tertiary education to the population aged 55 to 64 with tertiary education in 2008, in percentage, by age group.

Tertiary attainment levels have increased considerably over the past 30 years. In almost all countries, 25-34 year-olds have higher tertiary attainment levels than the generation about to leave the labour market (55-64 year-olds). On average across OECD countries, 35% of the younger cohort has completed tertiary education, compared with 20% of the oldest cohort. The expansion of the tertiary sector has put Japan and Korea in the top group together with Canada and the partner country the Russian Federation, with over 50% of the younger cohort with tertiary education.



1. Year of reference 2002.
 Countries are ranked in descending order of the percentage of 25-34 year-olds who have attained tertiary education.
 Source: OECD, Table A1.3a. See Annex 3 for notes (www.oecd.org/edu/eag2010).
 StatLink <http://dx.doi.org/10.1787/888932310092>

Source: <http://www.oecd.org/dataoecd/45/39/45926093.pdf>

We believe (as our leaders say) that we can fix the college attainment problem by graduating an additional 13 million students is a real “cop-out”, without finding out how we are going to improve the system. Just putting more people in a deteriorating system is not a long-term solution.

The following excerpt from William Blair’s Educational Services Report dated July 21, 2010 provides a very concise evaluation on the cost of adding 13 million new college graduates.

William Blair July 21, 2010 Educational Services Research Excerpt

Total taxpayer subsidies to public schools in 2008 were \$125 billion (excluding nearly \$10 billion in Pell Grant dollars) or roughly \$8,900 for each of the 14 million students enrolled. This compares to roughly \$1.4 billion of subsidies (excluding Pell Grant dollars) or \$775 per student for private sector schools. (Source: College Board, 2009 Trends in Student Aid, National Center on Education Statistics).

Put another way, using these figures, if higher education is to meet the administration’s goals for 13 million additional college graduates from either (or both) community colleges and public universities, taxpayers would be on the hook for roughly \$600 billion. This would be based on 5 million community college graduates (at a 22% graduation rate) plus 8 million graduates from public schools (at a 55% graduation rate) at an average subsidy of roughly \$8,900 per year (excluding Pell Grants).

Using the same graduation rates and time in school, the \$600 billion taxpayer bill from using the public sector to meet the administration’s goals compares to roughly \$250 billion if the private sector schools alone were responsible for creating 13 million graduates. Thus, taxpayers would need to come up with nearly **\$350 billion more in subsidies** (we could easily argue the bill would be higher if we included construction costs, additional G&A in support of these higher enrollments) if the government relies on the public sector to grow the relevant supply of degree granting seats.

Estimated Taxpayer Subsidies Required for 13 million Additional College Graduates				
	Using the Public Sector			
	Community Colleges		Public 4-Years	
Additional Graduates		5,000,000		8,000,000
Subsidy per Completing Student (1)	\$	17,800	\$	35,600
Gross Students Needed*	\$	22,727,273	\$	14,545,455
Subsidies Required	\$	177,636,363,636	\$	415,709,090,909
				\$ 593,345,454,545
	Using the Private Sector			
	2-Year Programs		4-Year Programs	
Additional Graduates		5,000,000		8,000,000
Subsidy per Completing Student (2)	\$	1,550	\$	3,100
Gross Students Needed*	\$	22,727,273	\$	14,545,455
Subsidies Required	\$	96,386,363,636	\$	155,709,090,909
				\$ 252,095,454,545
Additional Subsidy Required for Public Sector to meet Enrollment Goals				\$ 341,250,000,000

Source: National Center For Education Statistics, William Blair & Co. LLC estimates
 * assumes 22% graduation rate at community college and 55% graduation rate at 4-year public schools
 (1) assumes \$8,900 in subsidies per student per year
 (2) assumes \$775 in subsidies per student per year

Source: <http://www.intered.com/private-sector-documents/category/5-reports-analyses?currentPage=3>

Disclaimer:

We take full responsibility for any calculation, transposition or other potential errors.