Education Industry Study Summary

Lynn Ostrem
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After Apollo Group was presented to my club for review, I decided to take a closer look at the industry, as a whole, and the players that compete with Apollo. Here is my due diligence:

Postsecondary, for-profit education has become a thriving industry. There are over 2,500 for-profit institutions and many have seen growth well over 50% in recent years. For the largest few, analysts are forecasting earnings growth of a minimum of 20%-25% in the next 3-5 years.

The Department of Education states that postsecondary education is a $260 billion dollar industry in the U.S., with approximately 15.3 billion students currently. That figure is projected to climb 19% by 2012. Further, there's an estimated $54 billion available in federal student funding.

About 85% of the jobs in the U.S. now require skilled labor, up from 40% in the 1950s. And we've become a nation of job hoppers. Research shows that 25% of working adults want a career change in the next 12 months. Of these, 15% want to bring it about by going to school for training.

Companies in this industry tend to have solid financials, low capital outlays and lots of free cash flow. Plus there are good barriers to entry because potential competitors have to clear lots of regulatory hurdles.

The trends that have spiked this industry are:

- Higher required skill levels
- An increasing number of high school grads (growing 11% per year thru 2011)
- Demand for educated employees (70% will get further education; 14% of jobs will require it.)
- Growth in the popularity and convenience of online education
- Rising demand for healthcare career education (14% of all newly created jobs will be in the healthcare field)
- Increasing awareness of degrees (Census Bureau tells us that individuals with an Assoc. degree earns 23% more; those with a BA earn 52% more)
- Reduced funding for public education

The for-profit educators treat their students more like customers, giving them only the classes which are in demand, and alleviating the expensive frills of ivy-league schools, like beautiful campuses, libraries, athletics and research departments. They hire part time instructors who are currently experts working in the field they are teaching.

Top Competitors:

Apollo Group (APOL) This is the largest institution with more than 200,000 enrolled students (including online) at 71 campuses and 121 centers in 37 states, P.R. and Canada. They prefer to operate in larger metro areas with populations of 750,000 or more. Currently, they are in 24 of these metro areas—leaving plenty of room for growth. Over the next few years, Apollo plans to open 4-6 new facilities in 2-3 new states each year. They are also rolling out new degree programs. They enjoy a job placement rate of 90%, retention rates of 55% and student loan defaults under 6%--better than the industry norm. Apollo expects enrollment growth of 18% and price increases of 4-5% with improved margins at the newer schools. This equates to 22% to 24% EPS growth long-term on 25% revenues growth.

University of Phoenix Online (UOPX) This entity is a tracking stock of Apollo Group, who owns 87% of its common stock. Online education is the fastest growing and the most profitable area of education. Of Apollo's 200,000 students, 79,400 of them are enrolled in UOPX's online programs. The company expects to continue its 50%+ growth in enrollments, revenues and EPS for the immediate future. But with it comes the expectation of stiffer competition from its rivals.

Career Education (CECO) While Apollo grows by building new schools from scratch, Career Ed's strategy is to expand by purchasing under-managed schools and improving their performance. They cater to approximately 79,500 students at 74 campuses (including online) in the U.S., Canada, U.K., France and the Arab Emirates.

Analysts put the company's future EPS growth between 22% and 25% per year. Per Value Line, the company is trying to position itself to gain ground in the medical training field, since the Board of Labor Statistics has declared it one of the top 10 fastest growing occupations in the U.S. Career Ed has placement rates of 93%, retention rates of 77% and student loan defaults of just under 10%--good levels for this industry.

(NOTE: On November 17th, S&P suspended CECO's 5-star rating after a press report that a former director of career services at Gibbs College in New Jersey is suing the school for wrongful termination, claming she was fired for refusing to falsify student records. CECO says the lawsuit is without merit. Gibbs accounts for only 3% of their student population, and only $150 million of their projected $1.1 billion in revenues. On November 18th, S&P reinstated the 5-star rating, believing this is not an industry-wide situation.)

Corinthian Colleges (COCO) This school is already the largest provider of allied-healthcare education in the U.S. Value Line expects it to maintain its lead even though the others are gaining some ground. COCO has about 57,600 students in 82 schools and 2 training centers in the U.S. It also has 45 colleges and 15 training centers in Canada. Its goal is to achieve 25% revenues growth by rolling out 70 new programs per year (40 a year currently) and increasing their campus locations by 20% per year. This should easily allow them to increase earnings by at least 25%.

Education Management (EDMC) Once focused solely on the arts and culinary programs, EDMC has changed to health sciences, business, legal & behavioral studies, and information technology. They cater to 58,800 students on 66 campuses in 24 states and Canada. They still run 30 schools that cater to the Arts. The goal is to open at least 5 new schools every year for the foreseeable future, and increase their online presence. The company has guided analysts to 22% in revenues and 21% in EPS for the moderate future.

ITT Educational Services (ESI) Finally, this school is geared specifically for degrees in the computer sciences and information technology fields. They serve 33,000 students at 74 campuses in 28 states. Roughly 65% of the revenues are derived from government sponsored programs. And just like the others, they have been rapidly increasing their online presence. During the 3rd quarter, ITT increased their own EPS guidance to 28-29% for 2003, with mid-twenties further on.

Other Companies:

I also looked at **Sylvan**, which sold its K-12 curriculum recently to concentrate on the postsecondary education market. This restructuring has caused problems with the fundamentals, and it didn't seem suitable for consideration.

The Learning Tree had a horrible SSG, and has since been purchased by Corinthian Colleges. Hopefully, they can turn it around.

I also passed on **Strayer Education** which had insider ownership of over 75%, as well as declining profit margins. And **DeVry, Inc**. didn't pass the muster due to declining fundamentals.

Judgments on the SSGs:

Since all the companies have stated they can achieve above 20% growth, I have decided to cap my estimated sales and earnings at this amount. I will also cap my estimated high P/E at a PEG of 150%, or 30. To be consistent (although not necessarily conservative) I am using the 52 week low for all the stocks' estimated low price, ignoring any judgment for low P/E.

The following breakdown shows these SSG judgments, as well as some other pertinent information. Judgments are based on the price of the stock on December 2, 2004.

Education Study Summary Breakdown

by Lynn Ostrem
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	Apollo	Apollo Online	Career Ed	Corinthian	Education Mgmt	ITT Ed
Historical Sales	30.1	63.5	53.2	36.1	22.4	11.8
Historical EPS	42.3	120.8	78.8	188.8	31.5	22.6
Pre-Tax Profit	21.9 up	25.2 up	11.1 up	16.3 up	13.1 up	13.4 up
ROE	23.8 down	4.4 even	10.7 up	22.4 up	16.2 down	39 up
% owned by Mgmt	26%	87%	3.90%	5.50%	(CEO 6.9%) 2.5%	3.90%
Debt/Capital (SSG)	0%	0%	16%	22%	13%	0%
Relative Value (SSG)	124.60%	147.20%	171.80%	169.30%	125.30%	192.70%
Upside Ratio	0.62	-0.51	0.36	1.55	1.47	0.22
Proj. Average Return	4.21%	-9.19%	0.32%	5.25%.	8.08%	-2.01%
Recommendation	Hold	Sell	Hold	Hold	Hold	Sell
R2 (EPS predictability (SSG)	0.98	1.00	0.78	0.82	0.97	0.99
Sustainable Growth (SSG)	33.50%	NMF	16.30%	51%	22%	41.40%
PEG (SSG)	2.51	4.59	2.64	2.04	1.81	2.39
VL Financial Strength	A	B++	B+	B++	B+	B++
VL Earnings Predictability	95	NMF	85	NMF	100	85
My EPS Judgment	20%	20%	20%	20%	20%	20%
VL EPS (annual box)	31%	NMF	33%	30.50%	24.50%	16.50%
Consensus Judgment	24%	36%	25.80%	24.80%	20.20%	20%