Capella Education Company CPLA [Nasdaq] | Under Review

Last Price	Fair Value	Consider Buy	Consider Sell	Uncertainty	Economic Moat™	Stewardship	Morningstar Credit Rating	Industry
52.23 USD	—	—	—	—	Wide	B	—	Education & Training Services

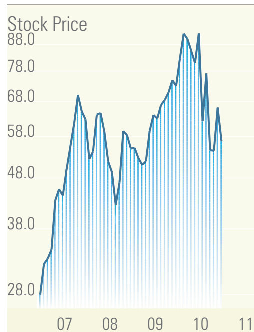
Capella Reports In-Line 4Q, Cites Additional Headwinds in 2011; Shares Remain Under Review

by Morningstar Equity Analysts

Analysts covering this company do not own its stock.

Pricing data through February 15, 2011. Rating updated as of February 15, 2011.

Currency amounts expressed with "$" are in U.S. dollars (USD) unless otherwise denoted.



Analyst Note Feb. 15, 2011 | Peter Wahlstrom, CFA

Capella Education posted in-line fourth-quarter and full-year results, but failed to offer any indication that the current headwinds have begun to abate. To the contrary, like many of its peers, Capella's management indicated that increased economic, regulatory, and market/competitive uncertainty has further clouded the near-term outlook. With many of the for-profit education providers now spending more on marketing to attract and retain higher-quality candidates and adjusting several of their programs and businesses to conform with potential Department of Education rule changes, we believe this will usher in a new era of more normalized enrollment growth and operating margins for even the better-positioned and well-regarded operators.

We are keeping our valuation under review while we rethink our near-term assumptions, which had previously factored in a more optimistic enrollment outlook for 2011. Management now expects a 35% drop in new enrollments for the first quarter of 2011, which sets the stage for a potentially volatile year. Management also announced Tuesday that it will cut 8% of its nonfaculty workforce and adjust its discretionary and market spending in response to current business levels, a prudent move, in our view.

While the near-term uncertainty surrounding the three primary factors listed above is unnerving, it is still our view that the intent of the Department of Education is not to permanently cripple the for-profit education industry, but rather increase transparency, accountability, and outcomes while addressing problem areas. This isn't an easy task or quick fix, and there are still plenty of moving parts at this stage. We see a case for mid-single-digit top-line growth for the better-run for-profit education providers over a longer-term horizon, which still produces solid returns on invested capital and earnings power, yet we recognize the near-term industrywide overhang, which is unlikely to be resolved until (at the earliest) the Department of Education releases its final rules, expected in the first half of 2011.

Thesis Jul. 27, 2010 | Todd Young

Capella Education is a well-positioned company in the highly profitable education industry. With high demand for education, price-insensitive customers, minimal investment requirements, government-aided pricing, and a solid industry position, Capella possesses a wide economic moat, in our opinion.

Industry dynamics in the for-profit education sector are very favorable. The demand for education is much higher than that which traditional not-for-profit schools can supply. For-profit education companies, like Capella, have stepped in to fill this gap. However, tuition pricing is typically set by traditional schools, which have higher cost structures, and financial-aid limits are based upon those prices. The intense demand and government-set pricing allow companies like Capella, which have lower cost structures, to provide educational services at prices similar to those of traditional schools. With the availability of financial-aid and corporate tuition assistance, students tend to be price-inelastic, as up-front, out-of-pocket costs are low. This helps Capella, and others, raise tuition at rates above inflation.

Along with good industry dynamics, Capella's focus on working adults and advanced-degree, online education has positioned the company rather nicely. The average age of Capella's students is roughly 40 years old, and more than 80% are enrolled in master's or doctorate programs. Although this demographic is less countercyclical than the younger trade school demographic, Capella should do well in both good and bad economic environments. During good economic times, there is less demand for education, as more people are employed. However, with higher employment, more people have access to corporate tuition assistance, helping to prop up demand for higher-level online degrees for working adults. Although Capella does not benefit as much as trade schools from increased demand during weak economic times, Capella's more

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Close Competitors	Currency(Mil)	Market Cap	TTM Sales	Oper Income	Net Income
Capella Education Company	USD	864	406	90	58
Apollo Group, Inc.	USD	6,181	4,994	1,025	548
DeVry, Inc.	USD	3,632	2,084	470	315

Morningstar data as of February 15, 2011.

financially mature customers are less likely to drop out, helping to keep demand stable.

Additionally, Capella student demographics help it avoid the recent student lending issues because of concerns in the credit market. Less than 1% of revenue comes from private student loans. With a default rate well below industry averages, students should have limited issues securing financing for their education.

Also, Capella's online focus bodes well for increased profitability. Its high-teen operating margins are well below those of some of its competitors, which boast margins above 30%. However, Capella has only been public since 2006 and has yet to perfect its systems and gain the same scale advantages as others. As long as the company can keep costs contained (especially marketing costs), we expect to see sizable profitability improvements as the company expands its enrollment numbers.

Valuation, Growth and Profitability

We are raising our fair value estimate to $105 from $95 due to higher growth profitability expectations. We forecast compound annual revenue growth of 17% through 2014. This forecast includes revenue-per-student increases as well as a compound annual student enrollment growth of 16%. We forecast operating margins expanding from 19% in 2009 to 25% in 2014, as the company should be able to leverage its fixed cost structure, given the sizable top-line growth.

Risk

As economic times remain difficult, corporations may be less willing to provide tuition assistance to employees, and layoffs could affect current students, lowering demand for Capella's services. Also, lower-margin bachelor's degree programs are growing faster than more profitable advanced-degree segments, potentially slowing profitability gains. The education industry is highly regulated, and new rules could adversely affect the company. An audit of Capella's practices, pertaining to refunding government-aided loans for students who have dropped out, could cause the company to return funds and potentially face fines.

Bulls Say

- Less than 1% of revenue is derived from private student loans, and less than 1% of students utilize private loans. This limits the company's exposure to credit issues pertaining to private student lending.
- Capella's student default rates are low. Its 2.5% cohort default rate in 2007 (the most recent available cohort) is well below even the rates experienced at not-for-profit institutions.
- With its online focus, Capella has significant room for margin expansion.

Bears Say

- As corporate layoffs mount, some students who previously received corporate tuition assistance may need to find other financing, or delay their education.
- As the economy remains weak, course loads per student may decline, which could lead to lower revenue.
- The Department of Education has proposed new rules

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that could limit growth or access to government financial aid for schools that fall outside of the proposed compliance standard.

Financial Overview

Financial Health: Capella is in excellent financial health. It has zero debt and more than $200 million in cash and marketable securities.

Company Overview

Profile: Capella is a regionally accredited, exclusively online postsecondary education company. It offers bachelor's, master's, and doctoral programs in behavioral health and human services, business management and technology, public service leadership, and education. More than 80% of students are enrolled in master's or doctoral programs. Capella serves roughly 39,000 students.

Management: In March 2009, Kevin Gilligan assumed the CEO position from founder Stephen Shank, who had served as CEO and chairman. In February 2010, Gilligan assumed the chairman role as well, with Shank remaining on the board. We think the recombining of the two positions is a step backward in terms of corporate governance. Gilligan most recently served as CEO of United Subcontractors, and previously was president and CEO of Honeywell International's second-largest business unit. Management compensation seems reasonable, and directors are compensated in both cash and equity. We would like to see a larger percentage of equity in their compensation, as some directors have limited equity exposure to the company. Increased exposure would better align their interests with those of shareholders.

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Analyst Notes

Feb. 15, 2011

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Feb. 07, 2011

Three-Year Trial Cohort Default Rate Data Hold Few Surprises, but Ample Room for Improvement

On Friday, the Department of Education released its fiscal 2008 "three-year trial" cohort default rates for postsecondary institutions, with little fanfare. The data was widely expected to provide a more grim snapshot of the number (and percentage) of borrowers in default on student loans, which it did. The total number of borrowers in default nearly doubled under the stricter three-year measurement standard to more than 465,000 students systemwide, representing 13.8% of total borrowers. What drew more attention, was the fact that defaults at proprietary education providers jumped 114% and the three-year borrower default rate reached 25%.

Under the current rules, colleges with two-year default rates of 25% or more for three consecutive years can lose eligibility for federal student aid; under the new rules, which go into effect next year, if default rates exceed 30% for three consecutive years colleges could lose eligibility. Most for-profit institutions are in decent shape, and there's time to adjust, but there's certainly ample room for improvement across the board.

The majority of the publicly traded for-profit education

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Analyst Notes (continued)

stocks were only down a couple percentage points following the release, with the exception of Universal Technical Institute (which separately reported a relatively weak outlook on Thursday evening) and Corinthian Colleges (where cohort default rates at its Everest College were in the 40% and 50% range). From an investor's standpoint, the data carried few major surprises, and the general stock reaction, while still negative, was somewhat rational and indicative of a more mixed and balanced sentiment than in the past.

We expect the Department of Education to publicly report preliminary cohort default rates for the 2009 federal fiscal year in the coming weeks, which could provide yet another catalyst for these stocks. Oddly, loans previously purchased by the Department of Education from the FFELP lenders (called "put loans") inadvertently excluded the cohort default rate data, which could add yet another layer of complexity (and confusion) to the upcoming release. We believe that, based on potentially lower overall service and quality of these loans, the fiscal 2009 data are more than likely to reflect yet another increase in overall cohort default rates.

Uncertainty surrounding pending regulatory changes is still a meaningful overhang, and it's extremely difficult to handicap the ultimate impact on the share prices. Shares of most for-profit education stocks appear to be excessively discounting the normalized earnings power of these businesses over the medium and longer term. While we are not updating our fair value estimates for these stocks on the basis of Friday's release, we continue to monitor this entire sector closely, and we await further updates from the Department of Education and Congress.

Dec. 09, 2010

Latest Congressional Report Raises Additional Questions Surrounding For-Profit Education Funding

Shares of Apollo Group dropped 3% Thursday, in line with most of the firm's publicly traded peers, following the release of yet another congressional report that highlighted concerns surrounding the for-profit education sector.

The publication, "Benefitting Whom? For-Profit Education Companies and the Growth of Military Educational Benefits," points out the dramatic increase in Department of Defense and Veterans Affairs funds to for-profit education companies over the past few years. For example, revenue from military educational benefits at 20 for-profit schools increased 211% between 2009 and 2010, while revenue from DoD and VA educational programs at 18 for-profit schools more than sextupled (to $460 million) over the past five years.

The release of the report is concerning on many levels. While it is not indicative of any wrongdoing on either party's side, it does raise some flags. For an industry that indirectly generates the vast majority of its revenue from the U.S. government through various loan and grant programs, we think regulators have a vested interest and reason to keep a close watch on the educational system, its inputs, inner workings, and outputs.

We recently took a fresh look at the proprietary (for-profit) education industry and the companies under coverage and downgraded our moat rating on Apollo Group because of subtle changes inherent in its business model and financials, largely as a result of pending regulation, which we believe adds near-term uncertainty to nearly all players across the for-profit education sector.

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Analyst Notes (continued)

Thursday's release reinforces our view. While we believe regulators do not intend to cripple this integral sector, the current message suggests that some level of change is required, and educators will probably need to adhere to a higher standard of accountability. Despite our pared-back growth forecasts, we continue to view shares of Apollo Group as undervalued and believe the current stock price does not fully reflect the company's normalized earnings power over the medium term.

Nov. 12, 2010

Capella Education Remains Under Review

We are keeping Capella Education under review as we continue to test the sensitivity of our operating assumptions. Given the Department of Education regulatory overhang, we believe that near-term uncertainty will continue among the for-profit education sector. We are still evaluating Capella's longer-term ability to gain market share, particularly in Associate/Bachelor degree and online markets, amid proposed regulatory changes and elevated competition from other education providers. Additionally, we plan to further analyze the firm's enrollment and tuition growth potential in North America, which is a key driver of our valuation.

Oct. 29, 2010

Reviewing our Take on the Education Industry

We are placing Apollo , Strayer, DeVry, and Capella under review while we take a fresh look at the for-profit education industry, and transfer coverage to a new analyst. We are also dropping coverage of the remainder of the stocks in the industry that we had covered to focus our resources elsewhere, including Corinthian Colleges, Career Education, UTI, ITT, Lincoln, Education Management, Bridgepoint , Grand Canyon, and K12. We had been underestimating the regulatory threat to this industry, and we intend to incorporate more explicit scenarios around potential new regulations into our fair value estimates. Additionally, we plan to take a fresh look at our economic moat analysis of this industry.

The regulatory environment around for-profit education firms has grown increasingly hostile in recent months, and is starting to bleed into the results of these firms even before anything is finalized. The firms that have already reported results this earnings season have all seen evidence of weakening enrollment, a trend we expect to continue well into 2011. For example, Apollo noted that it believes the negative media reports surrounding the industry have had some impact on demand, particularly in the more advanced degree segments, where consumers tend to be more politically aware. Also, the impact of companies taking matters into their own hands to lower their regulatory risk profile could be greater than we initially anticipated. We continue to believe that the impact will be far greater on the trade-based programs in general.

While we do expect to lower our fair value estimates for these firms, we still think the market is overshooting, and that the companies remain undervalued at today's levels. We will publish updated reports and fair value estimates for Apollo, Strayer, DeVry, and Capella as soon as possible, once we have incorporated a thorough analysis of these issues.

Oct. 26, 2010

Capella Expects a Decrease in New Enrollment

Not unlike other education companies that have reported

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Analyst Notes (continued)

earnings so far, Capella guided toward a slight decline in new student enrollment next quarter. This would translate into a 16%-17% year-over-year increase in total enrollment next quarter, compared to our estimate of 21%. The company cited competition from other for-profit companies that are trying to move upstream and capture more advanced-degree students. These students tend to be less risky as relates to regulatory issues in the industry and are therefore becoming more desirable in the current environment. Difficult comps as well as uncertainty in the economy were two additional drivers behind the expected decline in new enrollment, according to management. The company expects to make modest increases in marketing spending but still anticipates strong operating margin expansion due to fixed cost leverage. Additionally, Capella will now require students without any prior college experience to go through additional assessment. Since only about 20% of its students are in bachelor's programs or below, this should not have a significant impact on the company.

We are placing our fair value under review while we update our assumptions. We expect to decrease our near-term growth assumptions, which will result in a decrease in our fair value estimate. However, we don't expect to make a dramatic change, and the current stock price implies a much more drastic hit to the company's financial performance than we anticipate.

Oct. 15, 2010

Uncertainty Changes in Education Stocks

We are raising our uncertainty rating one notch for most of the companies in the education sector. The exception is Corinthian Colleges , which already has a very high uncertainty rating. The rest of the industry previously had a medium or high uncertainty rating, depending on various factors. The more trade-based programs generally serve a less financially mature student, typically experience a greater impact from the economy (they are more countercyclical), and have weaker student outcomes. As a result, we previously gave these companies a high uncertainty rating. We are now moving that segment to very high. This includes Career Education, UTI, ITT, Lincoln, and Education Management. The more degree-focused programs generally serve more sophisticated students, typically experience a smaller impact from the economy (they are more acyclical), and have better student outcomes. As a result, we previously gave these companies as medium uncertainty rating. We are now moving that segment to high. This includes Apollo, Bridgepoint, Capella, DeVry, Grand Canyon, and Strayer.

In light of this week's earnings release from Apollo, we feel the uncertainty surrounding the industry has increased. While we still believe that more degree-based companies will be able to weather the regulatory changes with limited downside impact, the fact that companies like Apollo are experiencing downward pressure before new regulations take hold makes the situation less predictable. Apollo noted that it believes the negative media reports surrounding the industry have had some impact on demand, particularly in the more advanced degree segments, where consumers tend to be more politically aware. Apollo could not quantify the negative media impact and, in our opinion, it appears to only be a small part of what is affecting Apollo; its new orientation program seems to be the key driver behind the near-term decline in enrollment and we believe this impact will be transitory. While we still believe that degree-based programs will not see a significant impact from regulatory changes, given that the negative media reports could

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Analyst Notes (continued)

impact these types of programs disproportionately, we believe raising the uncertainty rating for degree-focused schools makes sense. Also, the near-term impact of companies taking matters into their own hands to lower their regulatory risk profile could be greater than we initially anticipated. We continue to believe that any downside impact will be far greater on the trade-based programs in general. Therefore we are keeping those programs one notch above the uncertainty rating of the degree-focused schools, causing a shift in their ratings as well.

We reiterate that we believe higher-quality for-profit education companies as a group are deeply undervalued. At current valuations, many of them represent a good opportunity for patient investors willing to ride out the near-term volatility.

Aug. 16, 2010

Loan Data Shakes Up Education Industry

The Department of Education released preliminary data regarding its repayment rate calculation for its proposal on gainful employment. For the 12 for-profit education companies we cover, the data suggests that repayment rates are much worse than we anticipated. However, numerous companies have mentioned inconsistencies between their data and the numbers Department of Education released. Strayer , held a conference call this morning to explain some of these inconsistencies. Strayer's management had previously stated that it believed it would pass the 45% repayment rate measure, based on its internal data. However, the DoE's release suggested only a 25% repayment rate, well below the 45% standard for full eligibility. Additionally, DeVrynoted in a press release that it understands that the DoE intends to rectify an oversight in regards to the methodology used to calculate medical school repayment rates. DeVry's Ross University School of Medicine, had a repayment rate of only 16%, but Harvard's medical school repayment rate was also very low, at only 24%. This suggests that the repayment rate numbers released today may not reflect the quality of the programs.

Only three of the 12 companies we cover were above the 45% rate. Universal Technical Institute (49%-64%), Bridgepoint(45%-52%), and Grand Canyon (52%) were all above the 45% threshold. Apollo's University of Phoenix was close, at 44%. Other schools may have had some institutions above 45%, but not all. While schools may have passed the 45% threshold on an institutional basis, which is how the data was released, the actual rule would be enforced on a program-by-program basis. With aggregate levels close to the 45% limit, some of a school's programs may still be below the threshold.

Programs with repayment rates below 45% can still remain fully eligible if they pass a debt-to-income ratio test. However, the data surrounding this metric is even more obscure. Given the thresholds (8% debt-to-income or 20% debt-to-discretionary income) required to remain fully eligible, many of these schools could fall into a restricted category, which could limit enrollment growth substantially. If a school falls below a 35% repayment rate, and fails to meet a 12% debt-to-income and a 30% debt-to-discretionary income measure, it could lose access to financial aid support for its students. This would have a material impact on any school, as a significant portion of revenue usually comes from financial aid sources.

One of the key issues in the calculation, according to Strayer, has to do with how consolidation loans are calculated. When Strayer noted that it would likely pass the

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Analyst Notes (continued)

repayment measure, management had assumed that repayment rates on consolidation loans would be similar to its other loans. However, the DoE counts consolidation loans against a school if the student isn't paying any principal. With many consolidation loans offering interest-only and graduated income-repayment options, this could hurt many schools. Also, there are $130 million of loans missing from the DoE's calculation, compared to Strayer's calculation. The company had no insight into this difference, and is working with the DoE to rectify.

We believe that counting consolidation loans against schools doesn't make a lot of sense given that consolidating loans are often in a student's best interest, and schools do not control the terms lenders might offer. The DoE believes that some schools push students to take this option to lower their reported default rates--Strayer says it has no contact with students about this issue after graduation, and does not influence a student's decision. We believe that there are many flaws in the DoE's proposal, and that its data may not be accurate. There is no guarantee that the DoE will change its stance on its methodology surrounding consolidation loans. However, we believe that, once more accurate data is available, if quality institutions such as Strayer continue to score poorly, the DoE may decide to revisit its proposal.

Given our confidence in the quality of programs from Apollo, Bridgepoint, Grand Canyon, DeVry, Strayer, and Capella and our belief that they have a higher potential of passing the debt-to-income ratio, we are leaving our fair value estimates for these companies intact. With regards to the more trade-based, less degree-focused companies, we are placing our fair value estimates under review. While some of these companies have better repayment rates than some of the companies above, we question the current data. Additionally, operational issues, internal lending concerns, and a more countercyclical student base, give us more pause with regards to these companies. The list of companies that we are putting under review includes, Lincoln, Education Management, ITT Educational Services, Corinthian Colleges, and Career Education. Universal Technical Institute fits within the trade-based companies, but given that it passes the test under the current data, we are leaving our fair value estimate for its shares intact.

Overall, we think the murkiness of the data the DoE released, and the inconsistencies with the companies' own internal data, confirm our belief that the current gainful employment proposal will be difficult to actually implement. Also, we think the lack of correlation between the reported repayment rates and our assessment of the quality of the schools suggests that the proposal is ineffective in spotlighting the difference between valid programs and the bad actors in the industry. We have some concerns that the DoE might move forward with the proposal anyway, although we would hope that the DoE would at least make sure the data it is using is correct. But, given the uncertainty surrounding this proposal, we think investors are best served by focusing on the highest-quality companies. Additionally, we believe that the market has priced in an extremely pessimistic scenario for much of the space, presenting substantial upside.

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Capella Education Company CPLA

Sales USD Mil	Mkt Cap USD Mil	Industry	Sector
406	864	Education & Training Services	Business Services

Morningstar Rating	Last Price	Fair Value	Uncertainty	Economic Moat™	Stewardship Grade
Under Review	52.23	—	—	Wide	B

per share prices in USD

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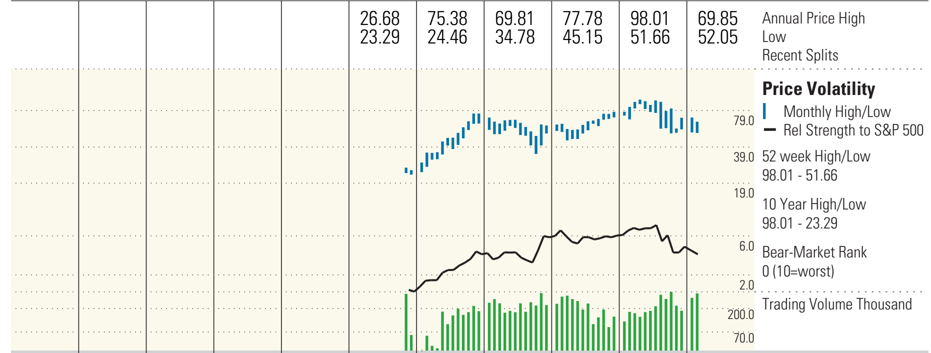
Capella Tower 9th Floor
Minneapolis, MN 55402
Phone: 1 888 227-3552Website: http://www.capellauniversity.com



Growth Rates Compound Annual

Grade: C	1 Yr	3 Yr	5 Yr	10 Yr
Revenue %	22.9	23.0	23.3	—
Operating Income %	59.4	53.0	45.3	—
Earnings/Share %	51.2	33.3	9.2	—
Dividends %	—	—	—	—
Book Value/Share %	30.1	21.7	—	—
Stock Total Return %	-26.0	-2.0	—	—
+/- Industry	-0.8	9.5	—	—
+/- Market	-49.9	-1.6	—	—

Profitability Analysis

Grade: C	Current	5 Yr Avg	Ind	Mkt
Return on Equity %	31.7	—	9.1	21.5
Return on Assets %	24.7	14.4	4.7	8.5
Fixed Asset Turns	10.0	8.2	5.5	7.3
Inventory Turns	—	—	76.6	14.6
Revenue/Employee USD K	317.9	237.8*	—	893.1
Gross Margin %	61.1	55.4	56.7	39.1
Operating Margin %	22.1	13.4	18.2	14.3
Net Margin %	14.3	9.5	4.5	9.5
Free Cash Flow/Rev %	12.0	11.4	13.6	0.1
R&D/Rev %	—	—	—	9.8

Financial Position

Grade: B	12-09 USD Mil	09-10 USD Mil
Cash	102	79
Inventories	—	—
Receivables	13	17
Current Assets	194	210
Fixed Assets	38	44
Intangibles	—	—
Total Assets	232	255
Payables	5	5
Short-Term Debt	—	—
Current Liabilities	37	41
Long-Term Debt	—	—
Total Liabilities	47	52
Total Equity	184	203

Valuation Analysis

	Current	5 Yr Avg	Ind	Mkt
Price/Earnings	15.2	31.4	13.4	16.9
Forward P/E	13.1	—	—	13.9
Price/Cash Flow	12.2	19.4	8.4	8.9
Price/Free Cash Flow	18.2	31.2	11.4	18.0
Dividend Yield %	—	—	0.5	1.7
Price/Book	4.3	6.1	3.2	2.3
Price/Sales	2.2	3.4	1.6	1.4
PEG Ratio	0.6	—	—	1.7

*3Yr Avg data is displayed in place of 5Yr Avg

Stock Performance

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	YTD
Total Return %	—	—	—	—	—	—	169.9	-10.2	28.1	-11.6	-21.6
+/- Market	—	—	—	—	—	—	166.4	28.3	4.7	-24.4	-27.5
+/- Industry	—	—	—	—	—	—	129.4	5.3	31.0	14.5	-20.1
Dividend Yield %	—	—	—	—	—	—	—	—	—	—	0.0
Market Cap USD Mil	—	—	—	—	—	373	1128	979	1262	1101	864

Financials

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM
Revenue USD Mil	—	30	50	82	118	149	180	226	272	335	406
Gross Margin %	—	28.8	43.4	—	50.0	52.3	53.5	55.7	55.8	59.6	61.1
Oper Income USD Mil	—	-14	-6	—	10	15	18	30	40	64	90
Operating Margin %	—	-45.9	-12.1	—	8.4	10.0	9.9	13.2	14.7	19.1	22.1
Net Income USD Mil	—	-13	-6	4	19	10	13	23	29	43	58
Earnings Per Share USD	—	-1.54	-0.58	0.39	1.62	0.86	1.06	1.33	1.66	2.51	3.43
Dividends USD	—	—	—	—	—	—	—	—	—	—	—
Shares Mil	—	8	10	11	12	12	13	17	17	17	17
Book Value Per Share USD	—	—	—	—	—	6.10	9.11	8.45	10.99	12.27	12.27
Oper Cash Flow USD Mil	—	-10	0	—	16	29	29	37	45	69	72
Cap Spending USD Mil	—	—	-4	—	-8	-9	-15	-16	-14	-16	-24
Free Cash Flow USD Mil	—	—	-4	—	9	20	14	21	30	53	49

Profitability

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	TTM
Return on Assets %	—	-54.3	-19.1	—	23.5	11.0	11.4	13.8	15.2	20.8	24.7
Return on Equity %	—	—	—	—	—	—	26.9	18.2	19.3	26.3	31.7
Net Margin %	—	-43.5	-11.4	5.4	16.0	6.9	7.5	10.1	10.6	12.8	14.3
Asset Turnover	—	1.25	1.67	—	1.47	1.60	1.53	1.37	1.43	1.63	1.72
Financial Leverage	—	—	—	—	—	18.2	1.4	1.3	1.3	1.3	1.3

Financial Health

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	09-10
Working Capital USD Mil	—	—	—	—	38	54	69	129	113	156	169
Long-Term Debt USD Mil	—	—	—	—	—	—	—	—	—	—	—
Total Equity USD Mil	—	-21	-26	—	0	14	94	157	141	184	203
Debt/Equity	—	—	—	—	—	—	0.00	—	—	—	—

Valuation

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	TTM
Price/Earnings	—	—	—	—	—	22.9	49.3	35.3	30.0	19.4	15.2
P/E vs. Market	—	—	—	—	—	—	—	—	—	1.1	0.9
Price/Sales	—	—	—	—	—	1.6	5.0	3.7	3.8	2.8	2.2
Price/Book	—	—	—	—	—	4.0	7.2	7.0	6.8	5.4	4.3
Price/Cash Flow	—	—	—	—	—	10.1	30.2	22.7	18.6	15.6	12.2

Quarterly Results

Revenue USD Mil	Dec 09	Mar 10	Jun 10	Sep 10
Most Recent Period	94.5	101.2	105.2	105.0
Prior Year Period	75.8	76.4	80.1	83.6

Rev Growth %	Dec 09	Mar 10	Jun 10	Sep 10
Most Recent Period	24.8	32.4	31.3	25.7
Prior Year Period	18.4	17.1	21.3	28.1

Earnings Per Share USD	Dec 09	Mar 10	Jun 10	Sep 10
Most Recent Period	0.89	0.89	0.86	0.80
Prior Year Period	0.65	0.49	0.56	0.57

Industry Peers by Market Cap

	Mkt Cap USD Mil	Rev USD Mil	P/E	ROE%
Capella Education Co	864	406	15.2	31.7
Apollo Group, Inc.	6181	4994	12.2	38.0
DeVry, Inc.	3632	2084	11.8	27.2

Major Fund Holders

	% of shares
American Funds NVIT Growth II	6.79
T. Rowe Price New Horizons	4.47
Waddell & Reed Small Cap A	2.42

TTM data based on rolling quarterly data if available; otherwise most recent annual data shown.

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MORNINGSTAR®

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Our Key Investing Concepts
- Economic Moat™ Rating
- Discounted Cash Flow
- Discount Rate
- Fair Value
- Uncertainty
- Margin of Safety
- Consider Buying/Consider Selling
- Stewardship Grades

At Morningstar, we evaluate stocks as pieces of a business, not as pieces of paper. We think that purchasing shares of superior businesses at discounts to their intrinsic value and allowing them to compound their value over long periods of time is the surest way to create wealth in the stock market.

We rate stocks 1 through 5 stars, with 5 the best and 1 the worst. Our star rating is based on our analyst's estimate of how much a company's business is worth per share. Our analysts arrive at this "fair value estimate" by forecasting how much excess cash--or "free cash flow"--the firm will generate in the future, and then adjusting the total for timing and risk. Cash generated next year is worth more than cash generated several years down the road, and cash from a stable and consistently profitable business is worth more than cash from a cyclical or unsteady business.

Stocks trading at meaningful discounts to our fair value estimates will receive high star ratings. For high-quality businesses, we require a smaller discount than for mediocre ones, for a simple reason: We have more confidence in our cash-flow forecasts for strong companies, and thus in our value estimates. If a stock's market price is significantly above our fair value estimate, it will receive a low star rating, no matter how wonderful we think the business is. Even the best company is a bad deal if an investor overpays for its shares.

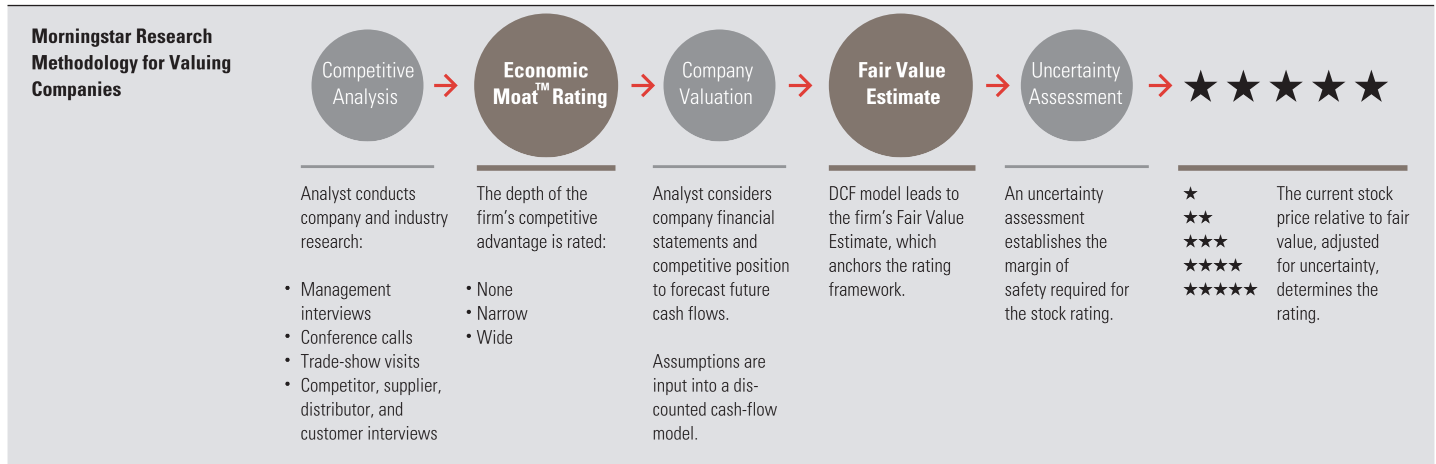
Our fair value estimates don't change very often, but market prices do. So, a stock may gain or lose stars based just on movement in the share price. If we think a stock's fair value is $50, and the shares decline to $40 without much change in the value of the business, the star rating will go up. Our estimate of what the business is worth hasn't changed, but the shares are more attractive as an investment at $40 than they were at $50.

Because we focus on the long-term value of businesses, rather than short-term movements in stock prices, at times we may appear out of step with the overall stock market. When stocks are high, relatively few will receive our highest rating of 5 stars. But when the market tumbles, many more will likely garner 5 stars. Although you might expect to see more 5-star stocks as the market rises, we find assets more attractive when they're cheap.

We calculate our star ratings nightly after the markets close, and issue them the following business day, which is why the rating date on our reports will always be the previous business day. We update the text of our reports as new information becomes available, usually about once or twice per quarter. That is why you'll see two dates on every Morningstar stock report. Of course, we monitor market events and all of our stocks every business day, so our ratings always reflect our analyst's current opinion.

Economic Moat™ Rating

The Economic Moat™ Rating is our assessment of a firm's ability to earn returns consistently above its cost of capital in the future, usually by virtue of some competitive advantage. Competition tends to drive down such



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economic profits, but companies that can earn them for an extended time by creating a competitive advantage possess an Economic Moat. We see these companies as superior investments.

Discounted Cash Flow
This is a method for valuing companies that involves projecting the amount of cash a business will generate in the future, subtracting the amount of cash that the company will need to reinvest in its business, and using the result to calculate the worth of the firm. We use this technique to value nearly all of the companies we cover.

Discount Rate
We use this number to adjust the value of our forecasted cash flows for the risk that they may not materialize. For a profitable company in a steady line of business, we'll use a lower discount rate, also known as "cost of capital," than for a firm in a cyclical business with fierce competition, since there's less risk clouding the firm's future.

Fair Value
This is the output of our discounted cash-flow valuation models, and is our per-share estimate of a company's intrinsic worth. We adjust our fair values for off-balance sheet liabilities or assets that a firm might have--for example, we deduct from a company's fair value if it has issued a lot of stock options or has an under-funded pension plan. Our fair value estimate differs from a "target price" in two ways. First, it's an estimate of what the business is worth, whereas a price target typically reflects what other investors may pay for the stock. Second, it's a long-term estimate, whereas price targets generally focus on the next two to 12 months.

Uncertainty
To generate the Morningstar Uncertainty Rating, analysts consider factors such as sales predictability, operating leverage, and financial leverage. Analysts then classify their ability to bound the fair value estimate for the stock into one of several uncertainty levels: Low, Medium, High, Very High, or Extreme. The greater the level of uncertainty, the greater the discount to fair value required before a stock can earn 5 stars, and the greater the premium to fair value before a stock earns a 1-star rating.

Margin of Safety
This is the discount to fair value we would require before recommending a stock. We think it's always prudent to buy stocks for less than they're worth.The margin of safety is like an insurance policy that protects investors from bad news or overly optimistic fair value estimates. We require larger margins of safety for less predictable stocks, and smaller margins of safety for more predictable stocks.

Consider Buying/Consider Selling
The consider buying price is the price at which a stock would be rated 5 stars, and thus the point at which we would consider the stock an extremely attractive purchase. Conversely, consider selling is the price at which a stock would have a 1 star rating, at which point we'd consider the stock overvalued, with low expected returns relative to its risk.

Stewardship Grades
We evaluate the commitment to shareholders demonstrated by each firm's board and management team by assessing transparency, shareholder friendliness, incentives, and ownership. We aim to identify firms that provide investors with insufficient or potentially misleading financial information, seek to limit the power of minority shareholders, allow management to abuse its position, or which have management incentives that are not aligned with the interests of long-term shareholders. The grades are assigned on an absolute scale--not relative to peers--and can be interpreted as follows: A means "Excellent," B means "Good," C means "Fair," D means "Poor," and F means "Very Poor."

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