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**Reason for Report:**  
Industry Overview

Related Companies:	Share Price:
APOL	38.05
APEI	36.71
BPI	16.80
CPLA	59.58
CECO	19.72
COCO	4.46
DV	44.36
EDMC	14.34
LOPE	18.84
ESI	62.61
STRA	141.98
UTI	19.77

## Business & Learning Services

### Is the PR Tide Shifting In Education Market?

#### CONCLUSION:

While it is much too early to signal "all clear" on the regulatory/legislative front for the postsecondary education companies, the tide in Washington does appear to be shifting in a direction somewhat more favorable to these much maligned companies. A revised and slightly more balanced GAO report on industry recruiting practices and more outspoken commentary on the part of Congressional Republicans point to a more balanced review of education oversight. This is an important, early step in making the postsecondary stocks investable again.

- Revised GAO report.** The GAO generated considerable negative buzz for the postsecondary industry with the August release (in conjunction with Senator Harkin's HELP committee hearing) of a "secret shopper" report that was highly critical of industry recruiting practices. The report drew on 80 hours of taped interviews by undercover agents at for-profit educational institutions. The revised report does not retreat from GAO's assertion that the industry encouraged fraud and misled potential students, but it does alter a number of the examples in ways that paint the industry in a less unfavorable light (see details on page two). We believe the revised report was motivated, at least in part, by efforts within the industry to gain access to the 80 hours of taped interviews. The revisions raise legitimate questions as to the balance of the GAO investigation, with Senator Enzi suggesting that the revisions "undermine many of the allegations" in the report.
- Increased Republican pushback.** Following the Republican victory in the recent elections, we see increasingly assertive Republican pushback to the perceived anti-industry bias of Senator Harkin. We believe the prospects for legislative action that would have a negative impact on the for-profit sector have been substantially reduced. In addition, certain Republicans are now calling for DOE to revisit (i.e., water down) components of its Gainful Employment proposals.
- It's NOT all good news from here.** While the intensity of industry criticism has diminished, we do not expect the for-profit sector to emerge unscathed. The program integrity rules will likely go through as proposed effective 7/1/11 (including the elimination of incentive comp for recruiters), and some form of Gainful Employment will likely survive. We continue to believe three things must happen before the education stocks can outperform on a sustained basis: 1) estimates must come down (in process); 2) growth expectations must be reset lower (also in process); and 3) regulatory clarity must be achieved (still several quarters away in terms of the impact of these change on earnings and growth).
- Stock Strategy - Selectivity is key.** We advise investors to focus on the companies with (1) the strongest records of regulatory compliance, (2) differentiated positioning and strategies for growth in an increasingly competitive marketplace, (3) above sector-average long-term growth potential, and (4) reasonable valuations. Our favorites based on these criteria (in order) are: LOPE, BPI, CPLA and DV. Our updated risk/valuation/growth matrix is on page three.

#### RISKS

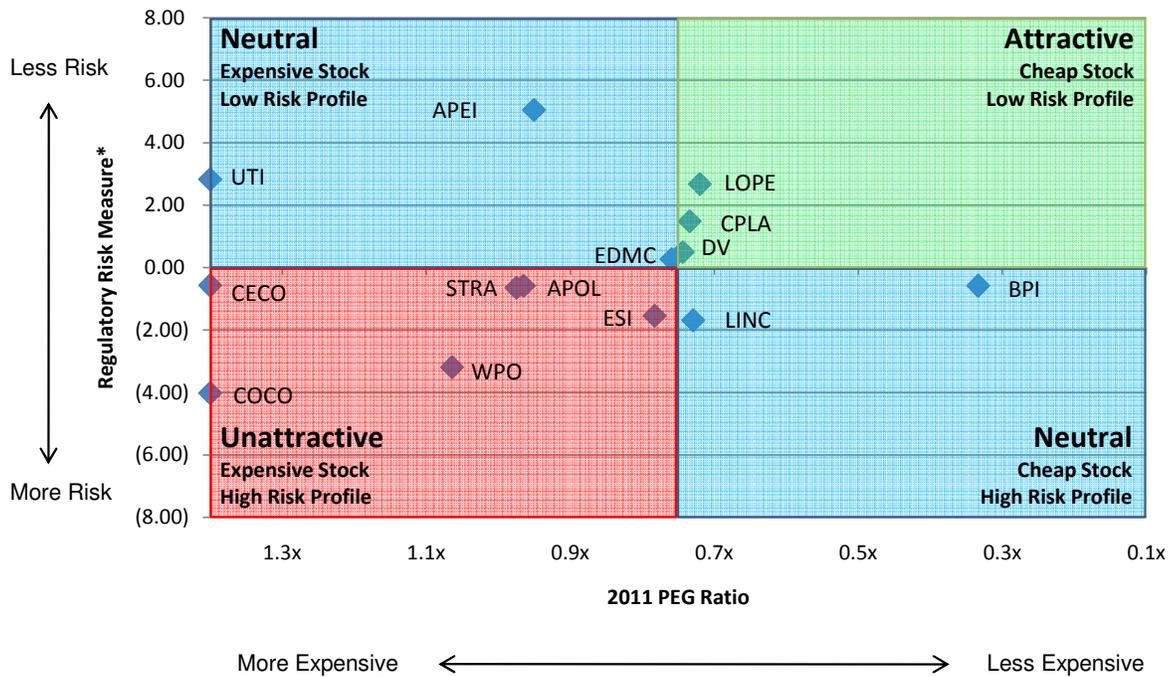
Slowing enrollment growth, increasing competition, regulatory/litigation risk.

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# Comparison of Original and Revised GAO Reports

Page reference	Original report	Revised report	PJC commentary
Page 8	The representative told the undercover applicant that by the time the college would be required by Education to verify any information about the applicant, the applicant would have already graduated from the 7-month program.	<b>The undercover applicant suggested to the representative</b> that by the time the college would be required by Education to verify any information about the applicant, the applicant would have already graduated from the 7-month program. The representative acknowledged this was true.	The source of the statement in question is reversed from the representative to the applicant, indicating the representative did not initiate the misconception.
Pages 12 & 25	Admissions representative told the undercover applicant that she should take out the maximum amount of federal loans she could, even if she did not need all the money. She told the applicant she should put the extra money in a high-interest savings account. While subsidized loans do not accrue interest while a student is in college, unsubsidized loans do accrue interest. The representative did not disclose this distinction to the applicant when explaining that she should put the money in a savings account.	Admissions representative told the undercover applicant that she <b>could</b> take out the maximum amount of federal loans, even if she did not need all the money. She told the applicant she <b>could</b> put the extra money in a high-interest savings account. While subsidized loans do not accrue interest while a student is in college, unsubsidized loans do accrue interest. The representative did not disclose this distinction to the applicant when explaining that she <b>could</b> put the money in a savings account.	Instead of claiming the admissions representative told the applicant she "should" take out the loans, the revised report indicates the representative told the applicant she "could" take out the loans, suggesting a less forceful tone.
Page 20	The career representative told the undercover applicant that getting a job is a "piece of cake" and then told the applicant that she has graduates making \$120,000 - \$130,000 a year. This is likely the exception; according to the BLS 90 percent of architectural and civil drafters make less than \$70,000 per year.	The career representative told the undercover applicant that getting a job is a "piece of cake" and then told the applicant that she has graduates making \$120,000 - \$130,000 a year. This is likely the exception; according to the BLS 90 percent of architectural and civil drafters make less than \$70,000 per year. <b>She also stated that in the current economic environment, the applicant could expect a job with a likely starting salary of \$13-\$14 per hour or \$15 if the applicant was lucky.</b>	The revised report indicates the career representative caveated the quoted high salaries with more realistic salaries given the current economic environment, demonstrating more transparency.
Page 21	Undercover applicant was told that he could earn up to \$100 an hour as a massage therapist. While this may be possible, according to the BLS, 90 percent of all massage therapists in California make less than \$34 an hour.	While <b>one school representative indicated to the undercover applicant that he could earn up to \$30 an hour as a massage therapist</b> , another representative told the applicant that the school's massage instructors and directors can earn \$150-\$200 an hour. While this may be possible, according to the BLS, 90 percent of all massage therapists in California make less than \$34 per hour.	The message changes meaningfully in the revised text, with the rep providing a realistic appraisal of compensation levels. The other rep offers a measure of upside for experienced/senior therapists.
Page 21	Admissions representative said the bachelor's degree would take 3.5 to 4 years to complete, but he provided a one-year cost estimate equal to 1/5 of the required credit hours.	Admissions representative said the bachelor's degree would take 3.5 to 4 years to complete. <b>He gave the applicant the cost per 12 hour semester, the amount per credit, the total number of credits required for graduation, and the number of credits for the first year. When asked if the figure he gave multiplied by four would be the cost of the program, the representative said yes, although the actual tuition would have amounted to some \$12,000 more.</b>	The admissions representative is revealed to have disclosed more information on the cost and number of credits needed to graduate, indicating higher levels of disclosure.
Page 22	Admissions representative told the undercover applicant that all graduates get jobs. He stated that the president of the college would employ students in his local salons if they did not find work elsewhere.	Admissions representative <b>suggested</b> to the undercover applicant that all graduates get jobs. <b>Specifically he told the applicant that if he had not found a job by the time he graduated from the school, the owner of the school would personally find the applicant a job himself.</b>	Admissions representative is now said to have "suggested" instead of "telling" the applicant that all graduates get jobs. The
Page 23	Admissions representative did not provide the graduation rate when directly asked, but said it is "very high." The college's web site also did not provide the graduation rate. Admissions officer was vague about graduation rate. She told undercover applicant that the last class had 16 people graduate, but did not say how many started.	When asked by the undercover applicant for the graduation rate for two programs, the admissions representative did not answer directly. For example <b>the representative stated that "I've seen it's an 80 to 90% graduation rate" for one of the programs but said for that information "I would have to talk to career services."</b> She also said 16 or 17 students graduated from one of the programs, but couldn't say how many students had started the program. The college's Web site also did not provide the graduation rate.	Revised report indicates the admissions representative conceded he would need to consult with career services for accurate graduation rates instead of claiming authority over the numbers, softening the evidence of misleading information.
Page 25	When the undercover applicant asked about the qualification of the professors, the only information provided about the qualifications of the professors is that they have professional experience.	[Sentence eliminated]	Indications of limited and/or vague disclosures on professors' qualifications removed in the revised report.
Page 26	Admissions representative said the program would cost between \$50,000 and \$75,000 instead of providing a specific number.	Admissions representative said the program would cost between \$50,000 and \$75,000 instead of providing a specific number. It was not until the admissions representative <b>later brought the student to financial aid that specific costs of attendance were provided.</b>	This initial implication was that the exact costs were not provided. These were provided by the financial aid counselor.
Page 27	Admissions representative did not disclose the graduation rate after being directly asked. The college's Web site also did not provide the graduate rate.	The college's Web site did not provide the graduation rate	Apparently, they didn't ask what the graduation rate was in this case.

# Regulatory Risk vs Growth-Adjusted Valuation



\* Equivalent to the sum of standard deviations from the mean, where a positive standard deviation implies favorable variance relative to the industry average, for three measures of regulatory compliance.

PEG ratios as of 12/08/10

Source: Company data, Piper Jaffray research

## Stock Considerations

Given the overwhelming importance of regulatory issues to near-term performance in the education sector, our near-term stock selection methodology is skewed toward companies with lower regulatory risk, as measured by the quantitative tool we use to measure company-specific regulatory risk (described in detail in our September 2010 Education Industry Primer). We combine our quantitative measure of regulatory risk with a valuation vs. growth metric to provide a more holistic view of the attractiveness of a stock.

We believe the education names can be grouped into three broad categories at this point:

**Attractive Now** - Lower regulatory risk, differentiated positioning and growth strategies, valuation that makes sense: LOPE, BPI, CPLA, DV

**Not Yet** - Either richly valued vs. group or with above-average regulatory risk  
APOL, APEI, UTI, EDMC

**To Be Avoided** - Excessive regulatory risk vs. valuation (generally the most volatile names and, ironically, the stocks that typically post the strongest performance on days when investors are Bullish on the sector)  
COCO, CECO, STRA, ESI

# Business & Learning Services

## Comp Sheet

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Company	Rating	Price Target	Price 12/08/10	Market Cap.	YTD Perf	CY EPS		EBITDA		Cash EPS		P/E Ratio		EV/EBITDA		Price/Cash EPS		3-5 Yr Growth	
						2010E	2011E	2010E	2011E	2010E	2011E	2010E	2011E	2010E	2011E	2010E	2011E		
<b>Post-Secondary</b>																			
American Public Education (APEI)	N	27.00	36.71	695	7%	1.54	1.93	56	68	NA	NA	23.8x	19.0x	11.0x	8.9x	NA	NA	20.0%	
Apollo Group (APOL)	N	43.00	38.05	5,818	-37%	5.25	3.90	1,118	1,134	NA	NA	7.2x	9.7x	4.6x	4.5x	NA	NA	10.0%	
Blackboard (BBBB)	NC	NC	42.83	1,490	-6%	1.60	1.94	116	141	NA	NA	26.8x	22.1x	13.5x	11.1x	NA	NA	19.4%	
Bridgepoint Education (BPI)	N	20.00	16.80	997	12%	2.07	2.52	220	269	NA	NA	8.1x	6.7x	3.5x	2.9x	NA	NA	20.0%	
Capella Education (CPLA)	N	61.00	59.58	1,001	-21%	3.64	4.06	112	127	NA	NA	16.4x	14.7x	7.3x	6.5x	NA	NA	20.0%	
Career Education (CECO)	U	14.00	19.72	1,574	-15%	2.46	2.38	371	355	NA	NA	8.0x	8.3x	3.1x	3.2x	NA	NA	5.0%	
Corinthian Colleges (COCO)	U	2.50	4.46	393	-68%	1.45	0.46	292	156	NA	NA	3.1x	9.7x	1.9x	3.5x	NA	NA	5.0%	
DeVry (DV)	N	55.00	44.36	3,179	-22%	4.30	4.59	525	564	NA	NA	10.3x	9.7x	5.2x	4.8x	NA	NA	13.0%	
Education Management (EDMC)	N	11.00	14.34	2,050	-35%	1.71	1.89	643	713	NA	NA	8.4x	7.6x	4.7x	4.3x	NA	NA	10.0%	
Grand Canyon Education (LOPE)	O	20.00	18.84	873	-1%	1.11	1.31	104	120	NA	NA	16.9x	14.4x	8.2x	7.1x	NA	NA	20.0%	
ITT Educational Services (ESI)	N	60.00	62.61	2,067	-35%	11.04	10.00	650	569	NA	NA	5.7x	6.3x	3.0x	3.4x	NA	NA	8.0%	
Lincoln Educational Svs. (LINC)	NC	NC	16.77	419	-23%	2.67	2.19	143	117	NA	NA	6.3x	7.7x	3.1x	3.8x	NA	NA	10.5%	
Strayer Education (STRA)	N	136.00	141.98	1,925	-33%	9.63	11.32	233	267	NA	NA	14.7x	12.5x	7.7x	6.7x	NA	NA	13.0%	
Universal Technical Institute (UTI)	N	17.00	19.77	485	-2%	1.21	1.43	76	90	NA	NA	16.3x	13.8x	5.3x	4.5x	NA	NA	9.0%	
Washington Post (WPO)	NC	NC	396.00	3,526	-10%	24.37	24.81	719	674	NA	NA	16.2x	16.0x	4.1x	4.3x	NA	NA	15.0%	
						<b>Average:</b>						<b>12.6x</b>	<b>11.9x</b>	<b>5.7x</b>	<b>5.3x</b>			<b>13.2%</b>	
<b>K-12</b>																			
K12 (LRN)	NC	NC	26.51	817	31%	0.65	0.78	61	86	NA	NA	40.8x	34.0x	13.2x	9.4x	NA	NA	27.9%	
Nobel Learning (NLCL)	NC	NC	7.00	74	-8%	NA	0.32	NA	17	NA	NA	NA	22.2x	NA	5.6x	NA	NA	NA	
						<b>Average:</b>						<b>40.8x</b>	<b>28.1x</b>	<b>13.2x</b>	<b>7.5x</b>			<b>27.9%</b>	
<b>Curriculum Content</b>																			
Archipelago Learning (ARCL)	N	10.00	8.73	223	-58%	0.29	0.38	22	28	NA	NA	30.4x	22.7x	12.5x	9.7x	NA	NA	20.0%	
John Wiley (JWA)	NC	NC	45.26	2,757	8%	2.75	3.06	NA	NA	NA	NA	16.5x	14.8x	NA	NA	NA	NA	5.3%	
McGraw-Hill (MHP)	O	44.00	35.99	11,131	7%	2.67	2.94	1,584	1,702	2.86	3.14	13.5x	12.2x	7.0x	6.5x	12.6x	11.5x	9.0%	
Pearson (PSO)	NC	NC	15.95	12,825	11%	1.12	1.14	1,642	1,638	NA	NA	14.2x	14.0x	9.1x	9.1x	NA	NA	NA	
Renaissance Learning (RLRN)	NC	NC	12.65	371	11%	0.75	0.85	37	NA	NA	NA	16.9x	14.9x	8.1x	NA	NA	NA	NA	
Rosetta Stone (RST)	N	15.00	22.25	456	24%	0.69	0.88	40	39	NA	NA	32.3x	25.4x	8.6x	8.9x	NA	NA	15.0%	
Scholastic (SCHL)	NC	NC	30.46	1,100	2%	2.37	2.49	224	222	NA	NA	12.9x	12.2x	5.7x	5.7x	NA	NA	NA	
						<b>Average:</b>						<b>19.5x</b>	<b>16.6x</b>	<b>8.5x</b>	<b>8.0x</b>			<b>12.3%</b>	
						<b>Overall Education Average:</b>						<b>15.9x</b>	<b>14.6x</b>	<b>6.8x</b>	<b>6.1x</b>			<b>13.8%</b>	
<b>S&amp;P 500</b>			<b>1228.28</b>			<b>80.68</b>	<b>93.24</b>					<b>15.2x</b>	<b>13.2x</b>					<b>8.0%</b>	

**Notes:**

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Source: Company data, Piper Jaffray estimates, FactSet

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			Count	Percent
BUY [OW]	310	49.80	69	22.26
HOLD [N]	265	42.60	30	11.32
SELL [UW]	47	7.60	2	4.26

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