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RESTRUCTURING THE FOR-PROFIT EDUCATION SECTOR: ENTERING A NEW ERA

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As with other regulated industries, the for-profit education sector has unique issues, which raise constraints when considering restructuring options. The following provides a background on how the industry reached its current state, identifies operating challenges, explains potential restructuring issues, and offers practical solutions.

Overview

The for-profit education industry started with "mom and pop" operators of local and regional schools providing certification programs in vocational trades and some diplomas. As Title IV financial aid grew as a source of revenue, professional managers and private equity sponsors became attracted to the industry. Today, many schools are owned by private equity firms, and the industry expanded both campus-based and online programs to provide bachelor, master, and doctorate degrees.

Public awareness of for-profit schools increased due to professional marketing, the proliferation of campuses, the prevalence of advertising in mainstream and online media, and student experiences of friends and relatives. Recent scrutiny by regulatory agencies and the media about questionable recruiting practices and jobless graduates with credit-ruining debt also raised public awareness and concerns about the industry.

From 2000 to 2010, industry revenue grew at a Compound Annual Growth Rate (CAGR) of 17.5%, from $5.9 billion to $29.6 billion.[1] The sector grew by offering a post-secondary education to students for whom tradtional schools were not well suited. Institutions grew quickly by building new campuses and adding programs both locally and online that were eligible for federal financial aid in the form of Title IV funds. Associate and bachelor degrees drove most of the growth in enrollments and revenue. Increased course offerings and evening sessions also provided flexibility for students from a broader demographic to pursue degrees.

Through 2010, there were 74 mergers and acquisitions totaling $11.8 billion.[2] Revenue growth and high-profit margins drove a large number of public and private transactions. Most for-profit schools with critical mass are either publicly owned or held by private equity firms. There are fifteen publicly traded schools that report financial and operating information to the SEC. Public valuations of for-profit education operators are under pressure due to decreased enrollments, poor outlook visibility, increasing regulations, and significant litigation risk. As of January 2014, fourteen (out of 15) publicly-traded, for-profit education enterprises had an average trailing twelve months EBITDA multiple of 5.0 (see Exhibit 1).

1 National Center for Education Statistics (NCES) – Integrated Postsecondary Education Data System (IPEDS).
2 Public Company Equity Research.

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Exhibit 1: For-Profit Education Valuations TTM EBITDA

Company	Ticker	Price	EBTIDA (S MM)	Secured Debt	Total Debt	Debt/ EBITDA	Mkt. Cap (S MM)	EV (S MM)	EPS	Forward P/E	EV/ TTM EBITD
American Public Education, Inc.	APEI	$39.56	$83.8	$0.0	$0.0	-	$696.5	$575.9	$2.5	14.7	6.9
Apollo Group Inc.	APOL	18.40	758.0	52.3	87.6	0.1	2,076.2	1,273.9	2.7	9.2	1.7
Bridgepoint Education, Inc.	BPI	16.28	213.7	-	-	-	880.9	452.4	2.3	20.2	2.1
Capella Education Co.	CPLA	47.93	67.0	-	-	-	594.0	449.2	2.6	17.1	6.7
Career Education Corp.	CECO	3.84	(22.8)	0.1	0.1	(0.0)	257.5	(30.2)	(3.2)	NM	NM
Corinthian Colleges Inc.	COCO	2.38	116.4	20.7	30.7	0.3	205.1	191.9	(0.1)	12.5	1.6
DeVry, Inc.	DV	30.78	333.6	-	-	-	1,935.7	1,663.7	2.3	12.7	5.0
Education Management Corp.	EDMC	7.10	386.7	1,088.5	1,319.1	3.4	884.7	2,020.2	(11.7)	24.4	5.2
Grand Canyon Education, Inc.	LOPE	35.76	146.3	100.4	99.0	0.7	1,626.8	1,574.2	1.7	19.5	10.8
ITT Educational Services Inc.	ESI	27.82	310.5	150.0	150.0	0.5	649.9	589.9	4.7	8.4	1.9
Lincoln Educational Services Corp.	LINC	6.76	24.0	35.9	35.9	1.5	162.3	180.9	(1.9)	219.4	7.5
National American Univ. Holdings, Inc.	NAUH	3.90	15.7	10.5	10.5	0.7	97.7	74.9	0.2	13.7	4.8
Strayer Education Inc.	STRA	50.55	127.0	124.2	125.2	1.0	520.2	594.6	5.3	13.3	4.7
Universal Technical Institute, Inc.	UTI	11.65	27.0	-	-	-	284.4	205.1	0.2	65.0	7.6
	Mean	**$21.62**	**$184.8**	**$113.0**	**$132.7**	**0.6**	**$776.5**	**$701.2**	**$0.6**	**34.6**	**5.1**
Note: Data as of 1/6/2014	**Median**	**$17.34**	**$121.7**	**$15.6**	**$20.6**	**0.2**	**$622.0**	**$514.2**	**$2.0**	**14.7**	**5.0**

Most investors in for-profit schools are attracted to the revenue provided by the federal government as Title IV financial aid. Over 80% of the revenue at for-profit schools comes from federal aid programs; the balance comes from state and work agency grants, family support and private loans.[3] For-profit schools participating in Title IV programs are required to be accredited by recognized national or regional agencies. The Department of Education ("ED") administers the Title IV program and disburses funds directly to schools to cover tuition, books, fees and living expenses. Title IV federal loan programs include Stafford, Perkins and PLUS loans requiring the student to carry the debt and repayment obligation.

Title IV disbursements grew at a 10% CAGR from 2000 to 2010, while for-profit revenue grew at 18% CAGR.[4] In 2010, for-profit schools received $32 billion in financial aid averaging $6,997 per

3 National Center for Education Statistics (see fn. 1)
4 The Parthenon Group.

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Exhibit 2: Title IV Revenues for 2008-2012 (in $Billions)

Ownership Type	2007-08	2008-09	2009-10	2010-11	2011-12
Pubicly Traded	$8.9	$15.4	$20.4	$21.4	$17.8
Privately Held	7.7	8.5	11.6	12.6	11.8
For-Profit School Totals	16.6	23.9	32.0	34.0	29.6
All Postsecondary Schools Total	$85.8	$105.7	$133.1	$145.7	$144.0
For-Profit School Share of Total	19%	23%	24%	23%	21%

US Department of Education Federal Student Aid

student.[5] For-profit schools absorbed a portion of the increase in federal aid by targeting the most eligible students, usually of lower-income means. From 2007-2012, total post secondary Title IV applications and awards increased almost 68%, from $85.8 billion to $144 billion (see Exhibit 2).

From 2000-2012, student enrollment in for-profit schools grew at a CAGR of approximately 16%. During this same time period, total post-secondary enrollment grew at a CAGR of less than 2%. For-profit schools increased their market share of total student enrollments from less than 3% in 2000 to 9.6% in 2010.[6]

The growth attributable to Title IV financial aid is highlighted in the revenue breakdown between 2007 and 2009 for University of Phoenix (APOL), Corinthian Colleges (COCO), and ITT Technical Institute (ESI), as shown in the table below. The incremental Title IV funds year-over-year account for more than 100% of total revenue growth, replacing declines in non-Title IV revenue in the same period.[7]

After consolidation and rapid growth, for-profit schools faced increased regulatory scrutiny as Congress learned that in 2012 for-profit schools enrolled approximately 11% of the postsecondary students in the country, received 25% of the financial aid awarded, and represented 47% of the loan defaults.[8]).

For-Profit Education Market

The for-profit education sector grew by offering a post-secondary education to students not suited for traditional schools. Much of the increased demand for post-secondary education is from nontraditional students who delayed college, are largely independent, older, and often work part or full-time while pursuing a diploma or degree. Non-profit schools (community colleges and traditional public and private colleges and universities) lack the flexibility and structure to address the needs of non-traditional students. Accordingly, for-profit schools account for 65% of students 25 years of age or older.[9]

5 Ibid.
6 Ibid.
7 Ibid.
8 Ibid.
9 Public Company SEC 10Q, 10K and 8k filings

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For-Profit Ed Revenue Growth

	2007	2008	2009
Apollo Group (APOL)			
Total Revenues	2,724	3,141	3,974
% YoY Growth		15%	27%
Title IV Revenues	1,770	2419	3537
%YoY Growth		37%	46%
% Revenue Grown from Title IV		**156%**	**134%**
Corinthian Colleges (COCO)			
Total Revenues	919	1,069	1,308
% YoY Growth		16%	22%
Title IV Revenues	691	866	1,163
%YoY Growth		25%	34%
% Revenue Grown from Title IV		**117%**	**124%**
ITT Technical Institute (ESI)			
Total Revenues	758	870	1,015
% YoY Growth		15%	17%
Title IV Revenues	477	635	863
%YoY Growth		33%	36%
% Revenue Grown from Title IV		**141%**	**157%**

Non-traditional students lacking parental support are typically heavier users of Title IV financial aid versus traditional students that usually receive financial support from their parents. For-profit schools competitively target non-traditional students by:

- Aggressive recruiting and heavy advertising
- Providing guidance to low income students on federal loan applications
- Developing highly focused, career-oriented programs
- Offering classes at multiple locations at convenient times as well as online.

However, the protracted economic recovery negatively impacted campus enrollments, because potential students are skeptical of the availability of higher paying jobs and want to avoid taking on the student debt (See Exhibit 3). Some for-profit schools are consciously

Exhibit 3: Total For-Profit Student Populations [10,11]

Ticker	FYE 2008	FYE 2009	FYE 2010	FYE 2011	FYE 2012
APEI	45,000	63,700	83,700	110,000	127,000
APOL*	362,100	443,000	470,800	380,800	328,400
BPI	31,558	53,688	77,892	86,642	81,810
CECO	98,000	105,300	116,800	98,000	76,000
Coco	64,928	80,939	105,494	90,507	91,460
CPLA	26,883	33,982	39,477	37,704	36,329
DV*	76,208	101,342	124,043	131,116	128,788
EDMC*	95,900	110,800	136,000	158,300	151,200
ESI	61,983	80,766	84,686	73,255	61,059
LOPE	24,636	37,709	41,482	43,917	52,292
STRA	44564	54,317	60,711	54,233	51,727
Total	**531,760**	**1,165,543**	**1,341,085**	**1,264,474**	**1,186,065**

* Fiscal year end other than December 31.

10 Public Company Equity Research.
11 United States Department of Education Office of the Inspector General July 23, 2013 Report - "Transparency of Proprietary Schools' Financial Statement Data for Federal Student Aid Programmatic Decision making".

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slowing their own growth in order to focus on student outcomes and comply with new industry regulations. Schools are implementing higher admission standards and moving away from open enrollments to become more selective and increase retention, graduation, and placements rates. In the short term, schools are expected to adapt to lower student populations and higher mix of online students.

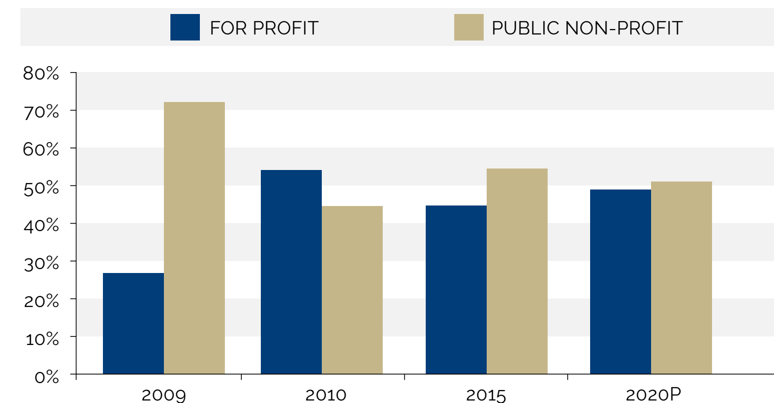
For-profit schools have been quick to develop and offer online programs that provide greater flexibility at a lower price point. Consequently, the majority of new student enrollments are in online programs. For-profit schools operating ground campuses continue to see quarterly declines in enrollments and are pressed to rationalize unprofitable campuses and programs.

Growth in Online Students

Since 2000, total online enrollment grew at a 31% CAGR to almost 2.5 million students in 2010. The growth rate is currently decreasing, but remains above traditional enrollments. By 2015, online enrollments are expected to grow to almost 3.5 million students. (see Exhibit 4) For-profit schools' market share of online enrollments is split roughly 50/50 with non-profit schools.[12] It is important to note though that within the for-profit sector, online enrollment, including both online-only and the combination of online / ground school, is estimated to account for 58% of total sector enrollment.[13]

Although online enrollments continue to increase, current studies show that most students do not complete the program or pass the final exam. Increasing regulation is putting pressure on for-profit schools to ensure that online diplomas and degrees lead to job placements and gainful employment.

Exhibit 4: For-Profit v. Non-Profit Online Market Share



Source: Strife Nicolaus

12 Public Company Equity Research.
13 Ibid.

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Working Capital and Liquidity

EBITDA margins declined from approximately 25% in 2010 to 18% in 2012.[14,15] Increasing regulation, declining enrollments, lower absorption of fixed costs, and decreasing advertising and lead conversion rates contributed to lower profitability. Pressure on EBITDA margins is expected to continue due to competitive pricing of tuitions, new regulations focused on student outcomes, and the related spending on student placement resources. All of these conditions negatively impacted working capital and liquidity.

Cost of Acquiring New Students

Since 2002, historical selling and marketing expenses for select publicly traded for-profit schools averaged between 20% and 25%.[16] During 2008-2010, total spending on selling and marketing increased from $2.7 billion to $3.6 billion, but dropped as a percentage of revenue from 25.1% to 22.3% due to disproportionate revenue growth.[17] From 2010 to 2012, aggregate marketing dollars stayed relatively flat between $3.6- $3.8 billion per year, but increased to over 25% of revenue due to lower revenue from declining enrollments, fewer leads, and lower conversion.[18]

Selling and marketing expenses typically include advertising, leads, recruiting, and admissions costs. It is difficult to calculate a standard cost of acquiring new students because companies do not report the expense categories consistently.[19] Using publicly reported information, the cost of acquiring a new student ranges from $1,800 to $4,000.[20] With such a high acquisition cost, for-profit schools feel the need to offer longer programs and degrees with higher tuition in order to increase the payback. However in many cases, for-profit schools' tuition costs for associate and bachelor degrees are higher than non-profit alternatives at community colleges and state universities. In addition, a large part of the market of prospective students wants *shorter and cheaper* programs that minimize debt and lead to better employment sooner.

Changes in Regulatory Environment

Beginning in 2009, for-profit schools suddenly faced increased regulatory scrutiny as Congress learned that for-profit schools accounted for a disproportionate share of defaults under the Title IV program. The U.S. Senate Committee on Health, Education, Labor and Pensions ("HELP" Committee) has oversight responsibility for the for-profit education sector. In April 2010, Chairman Tom Harkin initiated an investigation to better understand the enormous growth

14 Ibid.
15 See Footnote 11.
16 Public Company Equity Research.
17 Ibid.
18 Ibid.
19 United States Department of Education Office of the Inspector General July 23, 2013 Report - "Transparency of Proprietary Schools' Financial Statement Data for Federal Student Aid Programmatic Decision making".
20 Ibid.

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in both the number of students attending for-profit schools and the federal student aid investment that taxpayers are making in the schools. In July 2012, the HELP Committee issued its report titled "For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success."[21]

Summary of Key Findings: [22]

- In 2008-2009, for-profit colleges enrolled between 10%–13% of total students (over 2.2 million students), received 25% of all federal financial aid awarded, and represented 47% of all federal student loan defaults.
- More than 1 in 5 students enrolling in a for-profit school (22%) defaults within 3 years of entering repayment on their student loans.
- On average, for-profit schools spend 25% of revenue on advertising and recruiting, 17% of revenue on educating students and earn 19% in profits.
- The HELP Committee recommended enacting regulations that focus on student outcomes including retention, graduation, job placement and repayment rates.

21 United States Senate Health, Education, Labor and Pensions Committee (HELP) July 2012 Report – "For Profit Higher Education: The Failure to Safeguard the Federal Investment and Ensure Student Success."
22 National Center for Education Statistics (NCES) – Integrated Postsecondary Education Data System (IPEDS).

Since the release of the HELP committee report and other critical studies, a public debate ensued among politicians, academics, school operators, regulators, and accreditors on the efficacy of for-profit schools and a shift toward measuring student outcomes. In addition, the White House has taken a stern approach to holding for-profit schools accountable for the Title IV funds received for students. As a result, new regulation and changes to existing regulations were implemented and proposed.

In 2009, ED revised the 'safe harbor' rules for incentive compensation regulations essentially to forbid Title IV schools from providing any commission, bonus, or incentive payment to recruiters based solely on enrollments. Some schools are defendants in whistleblower lawsuits brought by former employees alleging violations in recruiting practices and performance compensation plans. Now, schools use outside professionals to help structure and draft compensation plans to maintain compliance and demonstrate objectivity.

Since 2010, other regulations were introduced that reduced the addressable market and funds available under certain programs like PELL. Students without high school diplomas had formerly been allowed access to Title IV under the Ability to Benefit ("ATB") guidelines. ATB students enrolled in vocational programs to improve

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their job skills. The Department of Education ended the ATB program abruptly in 2011. Many for-profit schools created offerings to appeal to ATB students and struggled to replace the loss of ATB students. ATB students represented upwards of 20% of the student population at some schools. Contraction in student enrollments started with the need to replace ATB students.

Currently, for-profit schools collecting Title IV funds maintain eligibility by complying with the following laws and regulations:

- Composite Score – Part of the Financial Responsibility Standards under the Higher Education Act to measure a school's financial health. Schools carrying debt are penalized in the calculation.
- 90/10 Rule – For-profit schools must receive less than 90% of total revenue from Title IV funds. Schools that receive more than 90% of revenues from Title IV funds in any two consecutive fiscal years will cease to be eligible to participate in Title IV programs.
- Cohort Default Rates ("CDRs") – Schools with a greater than 30% default rate for three consecutive years, or 40% in any one year, lose Title IV eligibility. This rule was originally measured for the first two years after graduation using a lower threshold.
- Gainful Employment – Measures the performance of placing students into jobs with wages adequate to repay their debt. The current proposed measures below are being considered in the Proposed Rulemaking Process and would not be implemented until 2015. Nonetheless, schools are using the measures to assess the potential impact on non-compliant programs.

A three-part test is being proposed:

1. Debt-to-Income Ratio – the ratio of monthly debt payments to monthly income must be less than 12%.
2. Debt-to-Discretionary Income Ratio – the ratio of monthly payments to monthly 'discretionary' earnings must be less than 30%.

A school is deemed non-compliant if it fails both debt measures in two of three years or if a school fails either debt measure in four consecutive years.

3. Program Cohort Default Rate ("CDR") – the percentage of students defaulting on federal loans within three years of graduation must be less than 30% A school is deemed non-compliant if it fails the CDR in three consecutive years.

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A school is deemed non-compliant if it fails the CDR in three consecutive years.

ED estimated that roughly 14% of existing programs at for-profit schools would likely fail under the proposed measures,[23] and BMO Capital Markets estimated upwards of 1,400 programs or 20% would fail.[24]

In addition to federal and state regulations, for-profit schools are dealing with inquiries and lawsuits from the SEC, the Consumer Financial Protection Bureau (CFPB), Office of Inspector General (OIG), accreditors, and the Department of Justice and States Attorney General.

Investors and lenders are rightly concerned about the significant regulatory and litigation risks in the sector.

Commentary on the Restructuring Issues

Many for-profit schools acquired by private equity firms took on term debt to finance the acquisition. In addition, schools typically require a revolver for the following purposes:

- To fund working capital needs during seasonal periods of lower student enrollments and timing of Title IV disbursements
- To draw down at fiscal year-end to improve the Composite Score calculation
- To fund necessary Letters of Credit in favor of ED and state agencies related to Title IV and grants
- To manage 90/10 Rule compliance and the ratio of Title IV to non-Title IV revenues

For-profit schools operating with leverage face tightening liquidity and could require restructurings or asset sales. However, it is difficult to de-lever given the low valuation multiples compared to leverage ratios. Schools carrying debt could be struggling with fixed charge and leverage covenants as year-over-year EBITDA decreases. Credit agreements also typically include covenants for regulatory compliance, which could be tripped for the Composite Score or the 90/10 Rule. Liquidity at some schools is so dire, payment defaults may occur.

School owners, operators, and lenders generally focus on the following primary issues:

23 National Center for Education Statistics (NCES) – Integrated Postsecondary Education Data System (IPEDS).
24 Public Company Equity Research.

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- Restructuring in Bankruptcy is not an option in this sector. Access to Title IV funds and accreditation are both forfeited under a Chapter 11 filing.
- For a lender, declaring a loan default jeopardizes Title IV eligibility and should be dealt with in an alternative way if possible (amendment, waiver, forbearance, standstill, etc.).
- Declaring a loan default also jeopardizes accreditations which are required for Title IV eligibility.
- Acquisitive companies booked significant goodwill and now face the risk of impairments which will reduce a school's Composite Score.
- A Composite Score violation could trigger a liquidity event if ED requires the school to post Letters of Credit.
- Campuses and program offerings are continually rationalized to maintain profitability.
- When a school shuts down, it is required to conduct a "Teach Out" plan to complete the instruction of its current students which typically uses up the remaining assets and suppresses liquidation recoveries.
- Capital Expenditures for growth and maintenance are limited due to tight liquidity, constraining the ability to remain competitive by developing new programs and refurbishing facilities.
- Acquisitions make a quicker impact to maintain compliance with the 90/10 Rule and CDRs.
- Some schools struggle with systems integration issues from acquired schools. Information systems and technology is a critical competency in this space.
- The SEC is investigating the use of private student loan programs which for-profit schools rely on for student gap financing that counts toward the "10 Money" (Revenue that counts toward the 10 in the 90/10 Rule).
- ED can be abrupt in its non-compliance notices, but slow to respond to counterarguments and appeals.
- Increasing regulations put downward pressure on enrollments and revenues because schools will have to cancel failing programs and be more selective in admissions to improve student outcomes.

Observations and Recommendations

Student enrollments may continue decreasing on a quarterly yearover-year basis as schools adjust to the demand of a more normal student population (See Exhibit 5).

Schools reliant on Title IV typically acquire other schools to add non-Title IV revenue or help improve regulatory compliance. Accredited schools with non-Title IV revenue, a good footprint, and a solid reputation are in demand. Consolidation may be a normal expectation, but the market conditions don't support it.

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Exhibit 5: Quarterly Year-Over-Year Results for Selected For-Profit Providers [25]

Companies	Qtr. Revenue	Qtr. Revenue YoY% Δ	Qtr. EBITDA	Qtr. EBITDA YoY% Δ	Qtr. Population	Qtr. population YoY% Δ	Qtr. Starts	Qtr. Starts - YoY% Δ	Qtr. Revenue/ Student	Qtr. EBITDA/ Student
American Public Education, Inc.	$ 81.8	6.0%	$ 20.9	3.2%	105,200	2.1%	22,100	-7.9%	777	199
Apollo Group Inc.	845.0	-15.2%	138.8	-3.4%	269,000	-18.1%	41,000	-22.3%	3,141	516
Bridgepoint Education, Inc.	185.6	-26.4%	21.6	-60.7%	68,566	-24.9%	12,500	-39.0%	2,707	315
Capella Education Co.	100.7	1.4%	16.6	6.4%	34,503	-1.4%	N/A	N/A	2,919	481
Career Education Corp.	251.3	-20.5%	(40.0)	-84.6%	56,300	-22.3%	15,470	-18.0%	4,464	(711)
Corinthian Colleges Inc.	365.0	-9.2%	10.6	-71.1%	80,032	-11.5%	28,551	-8.1%	4,560	132
DeVry, Inc.	450.9	-6.6%	41.2	-40.0%	124,085	-4.8%	N/A	N/A	3,634	332
Education Management Corp.	580.4	-4.8%	50.5	-6.1%	117,720	-8.5%	30,770	-6.1%	4,930	429
Grand Canyon Education, Inc.	152.4	14.1%	45.1	22.6%	59,914	14.7%	N/A	N/A	2,544	753
ITT Educational Services Inc.	259.4	-17.6%	38.3	-50.7%	60,997	-7.1%	20,307	5.2%	4,253	628
Lincoln Educational Services Corp.	88.5	-13.3%	1.2	-85.5%	16,105	-14.5%	6,523	-5.2%	5,495	72
National American Univ. Holdings, Inc.	30.9	4.7%	1.1	-15.4%	10,743	3.8%	N/A	N/A	2,879	105
Strayer Education Inc.	110.0	-11.5%	12.7	-8.6%	43,192	-16.5%	N/A	-23.0%	2,547	294
Universal Technical Institute, Inc.	91.0	-8.7%	6.4	-15.3%	13,800	-9.8%	2,500	-7.4%	6,591	465

Private owners would like to sell but EBITDA may be down and valuation multiples are low. Strategic acquirers meanwhile are rationalizing their holdings to the new environment and are also less acquisitive due to challenges in accessing the capital markets and the increasing cost of capital for this sector. Acquirers new to the industry are throttled by the need to get approved by ED and accrediting agencies for a change of ownership.

Distressed investors are interested in the sector; however, over leveraged schools struggling on multiple fronts are still not trading at distressed levels, offering few opportunities for now.

25 United States Department of Education Office of the Inspector General July 23, 2013 Report -"Transparency of Proprietary Schools Financial Statement Data for Federal Student Aid Programmatic Decision making."

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Increasing lender fatigue, concerns about the risk of association with schools in legal trouble, and the lack of refinancing exits may influence lenders to eventually sell their commitments to distressed investors. Students, investors, and lenders would be better served if for-profit school operators focused on refining their product and improving their core processes. Critical success factors for thriving schools will include:

- Price competitive programs with higher touch and a better experience to increase retention and outcomes
- Optimization of digital marketing, advertising, and recruiting to increase conversion and decrease cost of acquisition
- Improvements in cash management by linking organizational business processes between the financial aid and the finance groups
- Vigilance in using an Internal Audit function to enforce and maintain regulatory compliance and to create a constant readiness for regulatory reviews and renewals
- A market management approach that seeks to expand in successful existing markets before launching in new markets

Ultimately, for-profit schools need to provide an education product that is valued by employers. For-profit schools need to improve their product by continuing to focus on effective programs in strong job markets, but also by revisiting all aspects that touch the consumer. For example, some schools are revising their pricing and value proposition by lowering tuitions; some are offering scholarships which are effectively discounts; and others are using athletic teams and a traditional campus theme to increase student affinity with the school.

Campus-based programs are being revamped to include an online component that provides flexibility for the student to not have to come to the campus on Fridays. Conversely, online students may have a day on campus for a class, tutoring, group projects or labs. Schools are increasingly using technology to track students' progress and be able to intercede when student persistence is at risk. Strategies and approaches that help increase retention will directly increase profits.

For-profit education is a direct marketing business, and schools spend a lot of money on advertising and recruiting. Typically, there are opportunities to increase the cost efficiency of this operation by using third-party digital marketing firms to improve the quality of Internet leads, which increases conversion; optimizing the media buying function to get the right spots and day parts; and balancing the cost of internal call centers and outsourced capacity.

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With liquidity continuing to tighten, school operators should implement a cash forecasting process that is linked between the finance group and the financial aid processing group, since the majority of collections come from ED. Schools usually use a revolver to fund quarterly working capital needs and at fiscal year-end for 90/10 management and the Composite Score. The revolver is also typically structured to include capacity for posting letters of credit to ED and state agencies as recourse protection in case funds were disbursed that later need to be clawed back for noncompliance or other reasons. Most schools with debt do not have enough free cash flow to get through the year without using the revolver for working capital. Interest costs can be reduced and revolver availability can be conserved by using a 13-week cash forecast. The receipts section of the forecast should be provided by the financial aid group which manages the processing and disbursement of Title IV funds from ED. The finance group should work closely with the financial aid group to ensure processing resources are optimized. For example, it is cheaper to make the joint decision to pay overtime in the financial aid group to get loan batches processed than it is to draw on the revolver.

Many corporations use an internal audit group to take a disciplined and objective approach in risk management and controls. In for-profit education, internal audit groups can help ensure that business processes are systematically compliant with regulations and that data provided to ED and accreditors is accurate, complete, and timely. Schools spend significant resources on managing issues related to noncompliance. ED, accreditors, state agencies, the SEC, CFPB, OIG, and other regulators can all file subpoenas, information requests, Show Cause actions, and lawsuits at any time for noncompliance and business practices. Most schools think this is a cost of doing business and manage a docket of ongoing issues all toward ultimately settling without admitting wrongdoing. Other industries successfully use an internal audit group to minimize these types of risks and costs.

Expanding into new markets could cost upwards of $2.5 million in improvements and take up to two years to break even. In addition, property leases are usually signed for ten-year commitments with equal renewal options, and rent is the highest fixed cost for a school campus. Unprofitable campuses that are not able to absorb the facility costs would be shut down and taught out, but the ongoing lease commitment and cost prevent operators from grooming their existing markets. School operators should try to expand within existing successful markets before expanding into new markets

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because the payback is shorter, the marginal impact is greater, and the execution risk is lower. Schools can also increase cost absorption and profitability by adding programs at existing campuses that better balance students and resources. For example, campuses with surgical labs for surgical technician programs can offer sterilization and other programs that use similar training environments. Adding trade programs, such as commercial driving, HVAC, and auto tech to attract male students, which diversifies the demographic of the student population.

Ultimately, the for-profit education sector will continue to mature and evolve with the market, and the regulatory environment will be increasingly onerous on school operators. However, investors understand that for-profit schools fulfill a market need and that there is money to be made. The sector could benefit by working together to develop an image campaign – other than TV advertising to attract students, the sector does not do much to build a positive public image. Projected labor statistics and job studies suggest there will be a shortage of skilled workers, and the for-profit education sector is better positioned to address this shortfall than traditional schools. Inevitably, for-profit schools will have to restructure their operations to increase profitability and future growth. Similar to healthcare, food and other consumables, consumerism is increasingly driving students' decisions. For-profit education winners and losers will likely be defined by quality and price.

For a Self Study course on this topic based on a recent webinar with author Joseph D'Angelo and others, see www.AIRA.org

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